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SPECIAL TOPIC: EQUITABLE DISTRIBUTION

Essay

CRITIQUE OF WEST VIRGINIA'S NEW EQUITABLE DISTRIBUTION STATUTE

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The 1984 session of the West Virginia Legislature passed a comprehensive bill which sought to establish both the substantive and procedural elements of equitable distribution.¹ The legislature apparently intended to codify the exact parameters of the doctrine of equitable distribution in West Virginia. This legislative action was at least partly motivated by a desire to clear up some of the confusion which had resulted from the recent judicial adoption of the equitable distribution doctrine.²

The equitable distribution portion of the law found in West Virginia Code section 48-2-32 establishes the presumption that all marital property shall be divided equally between the parties without regard to marital fault which may be alleged or proven in the divorce action.³

Great care was taken by the legislature in defining and distinguishing "marital" and "separate" property,⁴ but there are at least three major provisions of the statute which continue to give rise to confusion and ambiguity, and which will require fairly extensive judicial interpretation. Those areas of ambiguity relate to: (1) The extent to which "separate" property can be distributed; (2) The treatment of mixed "separate/marital" property; and (3) The mechanics of judicial decisionmaking on equitable distribution. This Essay will identify these ambiguities and offer suggestions on how the intent of the legislature should be interpreted and how that intent could be clarified through statutory amendments.

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¹ Enrolled H.B. 1694, 1984 W. Va. Acts 391 (codified at W. VA. CODE §§ 48-2-1 to -2,-13,-15,-17,-22,-32,-36, 48-3-10 (Supp. 1984)).

² In *Patterson v. Patterson*, 277 S.E.2d 709 (W. Va. 1981), the court ruled that in a divorce action a constructive trust could be imposed upon property titled in one spouse's name when the other spouse demonstrates that he or she made financial or business services contributions towards the purchase of the real property. In *LaRue v. LaRue*, 304 S.E.2d 312 (W. Va. 1983), the court proceeded to recognize that homemaker services could entitle a spouse to a lump sum monetary award as an element of relief granted in a divorce action.

³ W. VA. CODE § 48-2-32(b)(3) (Supp. 1984).

⁴ Marital property is defined in W. VA. CODE § 48-2-1(c) (Supp. 1984); separate property is defined in W. VA. CODE § 48-2-1(d) (Supp. 1984).

I. DISTRIBUTION OF "SEPARATE" PROPERTY

A court's jurisdiction to distribute property of the parties would at first appear to be limited solely to division of marital property. The operative sections of the equitable distribution portion of the statute appear under the heading "marital property disposition."⁵ Within this heading a court's attention is routinely directed toward a consideration of "marital" property, until section 48-2-32(e), which incorporates the following language: "In order to achieve the equitable distribution of marital property, the court shall, unless the parties otherwise agree, order, when necessary, the transfer of legal title to *any property of the parties*." (emphasis added). The next sentence of the statute details the manner in which a court should approach a case involving the equitable distribution of "property acquired by *bequest, devise, descent, distribution or gift*..." (emphasis added), classes of property previously defined in the statute as separate property.

These references to "any property" and to a class of "separate property" appear in section 48-2-32(e), wherein the legislature made explicit its intent to protect a "business entity" from division or disruption by the court.⁶ Courts are specifically required either to order a monetary payment or to transfer "other property" of equivalent value to the spouse whose interest in a business has been severed and transferred to the other spouse. Thus, the authority of a court to reach separate property appears in the subsection devoted to the preservation or protection of "business interests" from "undue hardship or from interference" caused by a party or the action for divorce, annulment, or decree of separate maintenance. The *quid pro quo* for maintaining undivided ownership and control of a business entity or interest is the payment of a monetary award to the other spouse, or the conveyance, either by agreement or court order, of separate property of "fair value" to the spouse being divested of any interest in the business property. The court in the previous subsection (d) had already been directed to determine the results of a sale of property not susceptible of division⁷ and then to: "Ascertain the projected effect of a division or transfer of ownership of income-producing property, in terms of the possible pecuniary loss to the parties or other persons which may result from an impairment of the property's capacity to generate earnings."⁸

While many concepts in the statute are vague, the legislature's interest in protection of one class of marital property, "business interests or entities," is readily apparent in subsections (d) and (e) of section 48-2-32. No other class of marital

⁵ W. VA. CODE § 48-2-32 (Supp. 1984).

⁶ The legislature clearly intended that "business interests or entities" could constitute marital property and therefore be the subject of the court's consideration in making an equitable distribution award. Whether the business was solely the product of the marital efforts of both spouses or the separate property of one spouse, some portion of the business would constitute marital property so long as marital funds were expended in the business, or work was provided in the business by either or both of the parties during the marriage.

⁷ W. VA. CODE § 48-2-32(d)(5) (Supp. 1984).

⁸ *Id.* § 48-2-32(d)(6) (Supp. 1984).

property received such attention. Yet, with all of its consummate interest in the topic, the legislature failed to provide a definition of "business interest or entity" in the statute.

After the care taken to define "marital" and "separate" property in the definitional section of the statute, the legislature, without explanation in subsections (d) and (e) disregards the distinction and specifically authorizes the court to equitably distribute various classes of separate property. The courts are cautioned to "give preference to the retention of the ownership interests in such property,"⁹ but are not barred from ordering a transfer of such property.

Is the court ordered transfer of separate property an alternative available only to compensate the spouse who has been divested of his or her interest in a "business entity"? While the authorization for a court to transfer separate property appears in the "business entity" subsection, the authorization is not inextricably linked to the protection of "business interests or entities." Would this remedy not also be available as a means of achieving equity any time an item of marital property is not susceptible of division and one spouse is allowed to maintain sole ownership of that property? There could be difficulty in dividing many classes of marital property, both tangible, e.g. family home, and intangible, e.g. pension, or professional degree or license. The broad mandate contained in section 48-2-32(d) and (e) could be interpreted to open the way for courts to apportion both marital and separate property, even though courts must first give preference to achieving equitable distribution through "periodic or lump sum payments."¹⁰ This interpretation is reinforced by the absence of any language in the statute directing a court to designate separate property and set this property aside prior to the division of marital property.

This ambiguity could be resolved by the adoption of a clear policy position. First, West Virginia courts could divide all property of the parties, both separate and marital, an approach taken in fifteen other states. In those states, however, the legislation provides explicitly for the division of all property of the parties. Second, West Virginia could join the majority of equitable distribution states and divide only property designated as marital property. Under the latter approach, it is imperative that the courts be instructed to set aside the separate property to the respective owners prior to making a division of property determined to be marital. Courts could still consider the overall value of the separate estates of the parties in deciding what proportion of the marital estate to award to each party. The value of the separate estate, along with other discretionary factors such as the length of the marriage, the income earning abilities of each of the parties, and the age and health of the parties, could be weighed by a court in dividing the marital estate.

A clearer statutory dispositional scheme would involve three distinct phases. In the initial step, courts would determine the character of the property, i.e. separate

⁹ *Id.* § 48-2-32(e)(2) (Supp. 1984).

¹⁰ *Id.* § 48-2-32(e) (Supp. 1984).

or marital, and designate it as such. In the second step, the courts would value both classes of property and, if only marital property is to be divided, set aside that portion determined to be separate to the respective owners. Thus, courts could not actually reach separate property, yet the value of separate property received by each party could be used to weigh for or against greater than or less than equal division of the marital property. Only after the property had been characterized and the separate portion set aside would the court reach the third phase which would be the actual division of marital property.

The statute does not establish clearly whether and under what circumstances separate property may be divided, and further ambiguities are encountered where a single unit of property has both "separate" and "marital" elements.

II. TREATMENT OF MIXED "SEPARATE/MARITAL" PROPERTY

Under the statute, any increase in value of separate property can be either marital or separate property depending on its origin. That increased value which results solely from inflationary trends or other factors totally out of the control of the parties remains the separate property of the owner. An increase in value produced by the expenditure of *marital funds* or the *work* performed by either or both of the parties during the marriage is part of the marital estate. This distinction suggests that, in the case of separate property where both types of increase in value have occurred or have been alleged, the court must determine the financial history of the property and, where necessary, make detailed findings on how the increase in value was achieved.

Section 48-2-1(d)(2) defines as a class of "separate property": "Property acquired by a person during marriage in exchange for separate property which was acquired before the marriage." Thus, separate property which is used to purchase or improve marital property does not lose its separate character. This provision would likewise require a court to take evidence on the financial history of the parties' marital property so that the role of separate and marital funds could be traced and apportioned. It is likely that a great percentage of the parties' property will contain both separate and marital elements.

The manner in which courts have decided which portion of such mixed properties is marital and separate has varied across the country. The method contemplated by the West Virginia Legislature's effort to distinguish separate and marital property is the "source of funds" approach. Using this approach, courts must establish the source of the payments or improvements and then apportion the property by determining the ratio of marital and separate investments in the property.

Under a second method, "transmutation," separate property which is used to purchase or improve property during the marriage changes character and is transformed into marital property. By a third approach, "inception of title," property is characterized as of the date title is acquired; separate property and all

increase in value remains the property of the owner notwithstanding the use of marital funds or labor to purchase or improve the property. This is precisely the approach which was modified by the West Virginia Supreme Court of Appeals. Therefore, the West Virginia courts have two options to distinguish separate and marital property, either transmutation or source of funds.

The source of funds apportionment appears to have been codified under West Virginia Code section 48-2-1(c)(2) because the judge must determine the marital share where separate property has increased in value as the result of expenditure of marital funds or efforts. Similarly, source of funds apportionment seems to have been contemplated under section 48-2-1(d)(6), which provides that any increase in value of separate property due to inflation or change in market value remains separate property. Yet, the wording of section 48-2-32(c)(1)(B) would allow transmutation of marital property which is acquired with or increased in value by separate funds.¹¹ The court is required to consider the amount of separate property which a party used to acquire, preserve, maintain, or increase the value of marital property. This wording suggests that the separate funds were transformed into marital property or funds by being invested during the marriage.

Rather than providing for a determination of the character of property, setting aside that property which has been characterized as separate, and then dividing the remaining marital property, the approach taken in the majority of equitable distribution jurisdictions, the West Virginia statute brings the separate property back into the divisible marital pool and allows it to stay there. This portion of the statute suggests that separate property is transformed into marital property by being used to acquire property during the marriage. This transmuted separate property is subject to the presumptive 50-50 division.

Therefore, under the West Virginia statute, marital funds spent to increase the value of separate property remain marital and require an apportionment of the marital interest, but separate funds contributed to the acquisition, preservation, maintenance, or increase in value of marital property essentially become a part of the marital property. With this arrangement, if one spouse pays \$20,000 down on the purchase of a separate home one day before marriage, the \$20,000 remains his or her separate investment though any increase in the value of the house may be apportioned if marital funds have been used to increase its value. If, however,

¹¹ *Id.* § 48-2-32(c) (Supp. 1984) provides as follows:

(c) In the absence of a valid agreement, the court should presume that all marital property is to be divided equally between the parties, but may alter this distribution, without regard to any attribution of fault to either party which may be alleged or proved in the course of the action, after a consideration of the following:

(1) The extent to which each party has contributed to the acquisition, preservation and maintenance, or increase in value of marital property by monetary contributions, including, but not limited to:

(A) Employment income and other earnings; and

(B) ~~Funds which are separate property~~ (emphasis added).

that same \$20,000 is spent one day after marriage along with marital funds, the \$20,000 merges with the marital property and is presumptively subject to equal division unless the court alters that division.

Of the two approaches, source of funds appears to offer the more equitable solution to division of property acquired with a combination of funds. Whereas transmutation deprives one spouse of his or her separate assets regardless of his or her portion of the property acquired with each payment, the source of funds approach allows separate assets to be maintained, since the source of payments determines the characterization of the property. Under this approach, however, there is no guarantee that property acquired with other forms of separate property such as property acquired during the marriage by gift, bequest, devise, descent, or distribution would retain its separate characteristic. However, under a statutorily mandated source of funds approach, it would be possible for this type of property to remain separate.

In order to provide for source of funds apportionment under the statute, legislators would be advised to include in the definitional section, section 48-2-1, a proviso that when property is acquired with a combination of both marital and separate funds only that portion acquired in exchange for marital funds is to be considered marital and that portion acquired in exchange for separate property is to be separate. Further, the statute should be instructive as to the method of apportionment. For example, if one spouse contributes one-fourth of the purchase price of the marital home from his or her separate funds, he or she would receive one-fourth of the appreciated value of that home upon dissolution of the marriage. Also, the legislation should specify what will happen to the amount of outstanding indebtedness, that is, whether it should be divided as marital property or deducted from the value prior to division. Again, under section 48-2-32, the statute should provide for a three-phase dispositional scheme.

There are, however, disadvantages to the source of funds approach. First, it is difficult to apply in situations where the property to be divided is intangible property. It is easier to trace the amount of money spent to purchase a marital home than it is to calculate, for example, the value of a pension or the value of a professional degree to be awarded one spouse. These forms of intangible property, however, will usually be marital rather than mixed, so source of funds would rarely be applicable. The second disadvantage is there may be times when source of funds would not apply. For instance, where a couple has been married for many years and, although it may be possible to trace the purchase of property to separate funds, it may be more equitable to divide the property as if it were marital. As a practical matter, in such a case neither attorneys nor courts are likely to spend the time tracing the source of the funds and, in all likelihood, equity will be achieved.

Also problematic is the fact the statute does not define "net value" as used in section 48-2-1(c)(2). That portion of the statute defines marital property as the increase in value of separate property as a result of expenditure of marital funds to reduce indebtedness or otherwise increase net value. The two terms, indebtedness

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ness reduction and net value, though, have different meanings. Net value would seem to be only the equity the partnership has built up in the estate. Equity is usually the amount of the down payment and the amount of principal pay down plus appreciation. Reduction of indebtedness, on the other hand, necessarily includes payment of interest together with principal. For the first half of the life of a loan most of the mortgage payment is interest and very little equity is accumulated, yet debt is reduced enormously. If reduction of debts is the amount of increase considered marital property, the marital pool is considerably greater than if increase in net value or equity is the marital share. In most source of funds jurisdictions only the value of the equity would become marital property. The statute should clarify the definition of net value to insure uniform treatment of that portion of the property increased in value by the expenditure of marital funds.

III. MECHANICS OF JUDICIAL DECISIONMAKING

Two of the most difficult subsections to interpret are also among the most important, section 48-2-32 (c) and (d). These subsections incorporate the factors that a court may consider in deciding whether to award an unequal division of the marital estate, but the exact limits of judicial discretion are unclear.

If the parties have not executed a valid separation agreement defining the distribution of their marital estate, the court shall presume that all marital property must be divided equally between the parties. The terms of the agreement shall be honored by the court unless the court finds: (1) the agreement was secured by fraud, duress, or other unconscionable conduct by either of the parties; (2) the terms of the agreement would not be enforceable by a court as part of an order; and (3) "the agreement, viewed in the context of the actual contributions of the respective parties to the net value of the marital property of the parties, is so inequitable as to defeat the purpose of this section, and such agreement was inequitable at the time the same was executed."¹²

The court is not permitted to consider the fault of either party as alleged or proved in the divorce action in deciding whether to deviate from an equal division of the property. The court "*shall presume*" that an equal division of the marital estate must occur, but "*may alter* the distribution" after considering the factors listed in section 48-2-32(c)(1)-(4) in the manner described in section 48-2-32(d)(2) (emphasis added).

If one or both of the parties demand more than fifty per cent of the marital estate, the court must first evaluate the parties' monetary and nonmonetary contributions as described in section 48-2-32(c)(1) and (2) respectively. If an unequal division of marital property is warranted after consideration of these contributions, then the court must determine whether a party "(A) expended his or her efforts

¹² W. VA. CODE § 48-2-32(b)(3) (Supp. 1984).

during the marriage in a manner which limited or decreased each party's income-earning ability or increased the income-earning ability of the other party," or "(B) conducted himself or herself so as to dissipate or depreciate the value of the marital property."¹³

The party adversely affected by the facts underlying subdivisions (3) and (4) "who would otherwise be awarded less than one-half of the marital property,"¹⁴ may have his or her interest in the marital estate increased to one-half of the marital estate by consideration of these facts. This equitable adjustment can only occur "in the absence of a fair and just alimony award."

The method by which a court must analyze the factors listed in subdivisions (1) through (4) and the fact the presence or absence of an alimony award must be considered suggest that the legislature intended that an equal division of property would apply in the majority of cases and that the specified factors would be applicable to only certain limited fact situations.

While the statute identifies the factors to be considered in awarding unequal shares of marital property, the statute provides little guidance as to how those factors should be weighed. The courts will necessarily be left to develop applicable standards of measurement on a case-by-case basis.

Earlier drafts of equitable distribution bills considered by the legislature included a broader list of factors: the length of the marriage; the separate estate of the parties; contributions to the earning power of the other spouse, homemaking and child care services, pension benefits, or other insurance benefits available to the parties; tax consequences and such other factors deemed relevant by the court. Under these drafts the court could determine what weight to assign factors on a case-by-case basis and would not be held to an inflexible formula. Hopefully, legislative amendments in the 1985 session will correct the very confusing language of subsections (c) and (d).

IV. CONCLUSION

Overall, the new statute attempts to give the court and litigants sound guidelines for applying the principles of equitable distribution and the legislature should be commended. However, the areas of confusion and unclarity discussed in this article will have to be resolved either by the West Virginia Supreme Court of Appeals or further legislative enactment. Hopefully, the latter forum will make these corrections during the next session of the legislature and ease the long transition that parties and the courts must make in learning how to apply the principles and procedures of equitable distribution.

¹³ *Id.* § 48-2-32(d)(2) (Supp. 1984)

¹⁴ *Id.* § 48-2-32(d)(2)(B) (Supp. 1984).