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## Virginia'S Equitable Distribution Law: Active Appreciation And The Source Of Funds Rule

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# VIRGINIA'S EQUITABLE DISTRIBUTION LAW: ACTIVE APPRECIATION AND THE SOURCE OF FUNDS RULE

BRETT R. TURNER\*

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Significant intangible contributions to the substance of this article were made by all the members of the equitable distribution study group, and especially the chairman, Lawrence D. Diehl. The views expressed in this article are purely my own, however, and they do not in any way reflect the views of the committee as a whole. Other significant contributions were made by Elizabeth E. Ewing, Laura W. Morgan, and Warren A. Picciolo. Finally, I wish to thank Stephen R. Hart and Edward B. Gerber for their continued advice and encouragement.

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In late 1989, the *Washington and Lee Law Review* published my article on Virginia's equitable distribution law.<sup>1</sup> The article focused primarily upon classification of marital and separate property under Virginia's unique unitary theory of property, and paid special attention to the definition of acquisition and the classification of appreciated property.<sup>2</sup>

Even as that article was being published, however, the General Assembly was considering significant changes to Virginia's equitable distribution statute. Under the leadership of Lawrence D. Diehl, the legislative subcommittee of the Family Law Section of the Virginia Bar Association drafted legislation modifying the statute substantially.<sup>3</sup> The legislators were given the text of the proposed bill and a detailed explanation of it, and the initial reaction was favorable. After a period of discussion and several relatively minor amendments, both the House of Delegates<sup>4</sup> and the Senate<sup>5</sup> passed identical versions of the final bill. On April 6, 1990, Governor Wilder signed the Senate bill, and the proposed changes became law.<sup>6</sup>

As finally enacted, the new amendment makes major changes in Virginia's equitable distribution law. The unitary theory of property is repealed,<sup>7</sup> and the doctrine of transmutation has been changed signifi-

1. Turner, *Virginia's Equitable Distribution Law: An Owner's Manual*, 46 WASH. & LEE L. REV. 807 (1989).

2. *See id.* at 827-44.

3. H.B. 606, 1990 Session, and S. 90, 1990 Session. *See* Diehl, *Update on Transmutation in Virginia*, VIRGINIA LAWYER, January 1990, at 30 (discussing two early drafts of Virginia's new equitable distribution statute).

4. H.B. 606 (1990 Session).

5. S. 90 (1990 Session).

6. COMMONWEALTH OF VIRGINIA, GENERAL ASSEMBLY, FINAL CUMULATIVE INDEX OF BILLS, JOINT RESOLUTIONS, RESOLUTIONS AND DOCUMENTS (1990) (hereinafter cited as GENERAL ASSEMBLY INDEX). In addition, Governor Wilder signed the identical House bill on April 9, 1990. *Id.* Thus, the new amendments were fully enacted two separate times, and appear in two different chapters of the Virginia session laws. *See* 1990 VA. ACTS 636, 764.

7. VA. CODE ANN. § 20-107.3(A) (Supp. 1990). Unless otherwise noted, all cites herein to VA.CODE ANN. refer to the 1990 supplement.

cantly.<sup>8</sup> Most importantly, there is an entirely new set of statutory rules for classifying appreciation in separate property.<sup>9</sup> If the statute were an automobile, the 1990 changes are much more than minor additions and revisions. The General Assembly has issued a recall notice and comprehensively redesigned the vehicle.

This article will focus upon the new statute in two separate ways. First, it will describe the new rules, discussing how the new rules will operate in a number of common fact situations. Reference will be made not only to the text of the amendments, but also to the legislative history, which in several cases is as important as the text itself. Second, the article will evaluate whether the new amendments are likely to accomplish their purpose. The primary motivation behind the changes was a common perception among attorneys and legislators that Virginia's equitable distribution law suffered from serious flaws.<sup>10</sup> By comparing the new amendments with similar law in other states, we can determine whether or not the new amendment is likely to resolve these perceived shortcomings.

## I. LEGISLATIVE INTENT

### A. Policies Behind the Virginia Statute

The 1990 amendments were enacted to remedy several specific perceived problems with the law before 1990. Before looking at these problems, however, we should review briefly three basic features of the way Virginia divides property upon divorce.

#### 1. Equitable Distribution

First, at the risk of stating a truism, Virginia has chosen to divide property using an equitable distribution system. By choosing equitable distribution, Virginia rejected the other two major alternative methods of property division—legal title<sup>11</sup> and community property.<sup>12</sup>

Virginia's choice of equitable distribution over the other alternative methods of property division has important policy consequences. Any property division system must balance two competing policy goals: indi-

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8. *Id.* § 20-107.3(A)(3).

9. *Id.* § 20-107.3(A)(1).

10. See, e.g., Diehl, *supra* note 3, at 30; Diehl, *Transmutation in Virginia: Are We Drowning in the Pool of Marital Assets?*, J. VA. TRIAL LAW. A., Sept. 1989, at 26; Legislative Subcommittee, Family Law Section Board of Governors, Virginia State Bar Association, "Report and Recommendations on the Issue of Transmutation and Classification of Property in Equitable Distribution Proceedings" (1989) (hereinafter Legislative Subcommittee Report) (attached as an appendix to this article).

11. See generally L. GOLDEN, EQUITABLE DISTRIBUTION OF PROPERTY § 1.03 (1983 & Supp. 1990).

12. See generally *id.* § 1.04.

vidualism and sharing.<sup>13</sup> Individualism is the traditional economic principle stating that every person should receive the benefits or penalties of his own actions. In the property division context, a completely individualistic theory would award each spouse the property created by his or her efforts. If creation is defined restrictively to mean inception of ownership rather than origin of efforts, a completely individualistic theory would closely resemble the legal title theory Virginia followed before 1983.<sup>14</sup>

In contrast to individualism, community property methods of property division reflect the principle that husbands and wives should share all their property equally. The principle of sharing is a longstanding principle of Spanish and French law. Both Spanish and French law strongly influenced the law of the eight original community property states.<sup>15</sup> In common-law states, legislators and courts originally chose individualism over sharing, and expressed this preference in a legal title system.<sup>16</sup> Sharing principles were not ignored, but common-law states assumed that sharing occurred naturally during the marriage. It was necessary to enforce sharing when the marriage ended, of course, but even then the common-law states did not require actual sharing of property. Instead, common-law states implemented sharing indirectly, by requiring the husband to support the wife indefinitely at the marital standard of living.<sup>17</sup>

In the 1970s and 1980s, the rising divorce rate and the increasing affluence of women caused alimony to become less a vehicle for sharing and more a device for rehabilitation.<sup>18</sup> This change prevented courts from

13. See generally Reynolds, *Increases in Separate Property and the Evolving Marital Partnership*, 24 WAKE FOREST L. REV. 239, 242-44 (1989). Reynolds discusses the philosophies of individualism and sharing at some length, but she does not view the two philosophies as competing equals. Instead, she admits that her article "promotes a philosophy of sharing over a more individualistic philosophy as appropriate to the marriage relationship." *Id.* at 244 n.12. This article, by contrast, views the choice between the competing policy goals of individualism and sharing as a choice best resolved in the political arena. Reynolds makes an excellent case for her position, however, and she demonstrates well how courts can move toward a more sharing-oriented, less individualistic scheme of property division.

14. See *Ernsberger v. Ernsberger*, 224 Va. 1, 294 S.E.2d 794 (1982) (holding that Virginia courts had no authority to transfer title to property during divorce proceedings); *Watkins v. Watkins*, 220 Va. 1051, 265 S.E.2d 750 (1980) (same).

15. See Reynolds, *supra* note 13, at 249-52.

16. See *id.* Indeed, the strong tendency toward individualism caused early American community property decisions to reject some of the broad sharing principles of Spanish civil law. See Reynolds, *supra* note 13, at 252-58.

17. See L. WEITZMAN, *THE DIVORCE REVOLUTION* 145-47 (1985); Smith, *The Partnership Theory of Marriage: A Borrowed Solution Fails*, 68 TEX. L. REV. 689, 694 (1990).

18. See L. WEITZMAN, *supra* note 17, at 147-50; see also U.M.D.A. prefatory note, 9A U.L.A. 147, 147 (1987); L. GOLDEN, *supra* note 6, § 1.02. The Uniform Marriage and Divorce Act (the Act) was completed in 1970 at the very start of the equitable distribution revolution. The Act allows for spousal support only if the wife cannot support herself from her own property or earnings. U.M.D.A. § 308, 9A U.L.A. at 347. To compensate for this limitation, the drafters wrote the first modern equitable distribution statute. U.M.D.A. § 307, 9A U.L.A. at 239. See H. CLARK, *THE LAW OF DOMESTIC RELATIONS IN THE UNITED STATES* § 17.1 at 256-57 (2d ed. 1987) (discussing modern limitations upon concept of alimony); Smith, *supra*

implementing sharing through alimony and caused eventual widespread rejection of the title theory.<sup>19</sup> Recent authors have continued to emphasize sharing as the best way to protect women and children from the economic consequences of divorce.<sup>20</sup> A complete sharing-oriented theory of property division would resemble traditional community property law, with its strong emphasis upon joint ownership and its requirement that community assets be divided equally upon divorce.<sup>21</sup>

By choosing equitable distribution, Virginia has opted for a middle ground between individualism and sharing. When property is acquired from nonmarital sources, the statute defines it as separate property, thus preserving for the owner the benefit of his or her nonmarital efforts.<sup>22</sup> When property is acquired during the marriage, by contrast, the statute implements sharing principles by classifying the property as marital, regardless of whose efforts created it.<sup>23</sup> The preference toward sharing is tempered by the use of relative contributions to the marriage as a factor in dividing marital property. Relative contributions, however, is only one of a number of factors relevant to the overall division of marital property.<sup>24</sup> As we shall see, the new amendments continue the previous emphasis upon balancing both individualism and sharing.<sup>25</sup> It is important, therefore, that both policies be considered in construing the statute.

## 2. The Marital Partnership Theory

Second, the Virginia statute clearly follows the marital partnership theory of marriage.<sup>26</sup> Under this theory, the parties' property should be

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note 17, at 694 (noting that traditional concept of alimony depended upon widespread assumption that marriage was permanent—an assumption that was questioned increasingly during 1960, the last decade before equitable distribution).

19. See generally L. GOLDEN, *supra* note 6, §§ 1.01-1.02.

20. See, e.g., L. WEITZMAN, *supra* note 17; Prager, *Sharing Principles and the Future of Marital Property Law*, 25 U.C.L.A. L. REV. 1 (1977); Reynolds, *supra* note 13.

21. Such a theory would not, of course, be identical to traditional community property law. That law restricted sharing in many obvious and subtle ways, including notably the longstanding refusal to treat active appreciation in separate property as community property. See generally Reynolds, *supra* note 13. With its theory of joint ownership during the marriage and its requirement that community property be divided equally, however, traditional community property law comes closer to an absolute sharing requirement than present equitable distribution law.

This is not to say that community property states implement sharing better than equitable distribution states. Indeed, I agree with Professor Reynolds that more progressive equitable distribution states do a better job of implementing sharing principles specifically upon divorce. See *id.* at 243. When we consider the marriage as a whole, however, including ownership during the marriage and distribution upon death, community property is the more sharing-oriented and less individualistic theory.

22. VA. CODE ANN. § 20-107.3(A)(1).

23. See *id.* § 20-107.3(A)(2) (except for gifts and inheritances, property acquired during marriage is marital property, regardless of whose efforts acquired property).

24. See *Smoot v. Smoot*, 233 Va. 435, 357 S.E.2d 728 (1987).

25. See *infra* notes 332-33 and accompanying text.

26. *Williams v. Williams*, 4 Va. App. 19, 24, 354 S.E.2d 64, 66 (1987) (Virginia statute "is intended to recognize a marriage as a partnership").

divided in proportion to the contributions they have each made to the marriage.<sup>27</sup> Virginia law does not tell us how to define or measure contributions, but clearly the process requires more than reference to an economics textbook. Contributions with a low economic value may nevertheless be given a higher value for purposes of property division.<sup>28</sup> The proportional division requirement of the marital partnership theory is a classic attempt to implement an individualistic philosophy within a marital context. The flexible law on valuing contributions, however, reflects the influence of the philosophy of sharing.

While most states follow the marital partnership theory in some form,<sup>29</sup> there are other theories regarding the proper treatment of marital property.<sup>30</sup> Virginia could have followed the lead of some community property states and required an equal division of marital property,<sup>31</sup> or it could have reduced significantly the role of contributions to the marriage in the ultimate division of property.<sup>32</sup> Virginia's ultimate choice to adopt the marital partnership theory shows a preference for individualism, tempered by a broad sharing-based definition of contributions to the marriage.

### 3. Dual Classification

Third, Virginia has chosen the "dual classification" model of property division. Under this model, the court's power to divide property extends only to a limited class of "marital" or "community" property.<sup>33</sup> Property

27. See *Williams v. Williams*, 4 Va. App. at 24, 354 S.E.2d at 66 (1987) (property should be divided equitably "based on the monetary and non-monetary contributions of each spouse"); L. GOLDEN, *supra* note 11, § 1.01

28. For instance, property awards to full-time homemaker spouses regularly exceed the total economic value of their homemaker services. See, e.g., *Bidwell v. Bidwell*, 122 A.D.2d 364, 504 N.Y.S.2d 327 (1986) (trial court did not err by refusing to accept expert testimony on economic value of wife's homemaker services; economic value of such services not relevant to equitable distribution); *Smith v. Smith*, 294 S.C. 194, 363 S.E.2d 404 (Ct. App. 1987) (expert testimony relevant, but trial court's property award not limited to uncontested economic value of wife's homemaker services).

29. See L. GOLDEN, *supra* note 11, § 1.02 at 3 (stating that almost all states embrace partnership theory of equitable distribution).

30. See, e.g., Glendon, *Is There a Future for Separate Property?*, 8 FAM. L.Q. 315, 318 (1974) (noting that in West Germany and Sweden, systems resembling equitable distribution are increasingly limited in favor of return to title theory); Oldham, *Is the Concept of Marital Property Outdated?*, 22 J. FAM. L. 263, 268 (1984) (arguing that no marital property should be accumulated until marriage lasts five years or child is born); *Smith*, *supra* note 17, at 689 (arguing that marital partnership theory has failed entirely, and suggesting supplementing marital partnership theory with automatic continuing award based upon the difference in parties' incomes).

31. See, e.g., CAL. CIV. CODE § 4800 (West Supp. 1990) (requiring that community estate be divided equally upon divorce).

32. For instance, Virginia now requires the award of premarital property to the owning spouse. VA. CODE ANN. § 20-107.3(A)(1)(i). If Virginia had enacted an all property rather than a dual classification system, however, acquisition before the marriage would be only one relevant factor in the overall division. See *infra* notes 33-35 and accompanying text.

33. See L. GOLDEN, *supra* note 11, § 2.01.

falling outside this class is known as "separate" or "nonmarital" property, and the court must award such property to the owning spouse. The dual classification model can be contrasted with the "all property" model, under which the court can divide all property owned by either party, regardless of how the property was acquired.<sup>34</sup>

Virginia's rejection of the all property model demonstrates several policy preferences. First, a dual classification system provides as a matter of law that certain types of "nonmarital" property are not to be shared between the parties. An all property system, by contrast, allows the court to order sharing of any asset when equity so requires. Although trial judges in all property states have discretion to award nonmarital property to the owner or at least to divide nonmarital property unequally, trial judges are generally reluctant to do so.<sup>35</sup> In all property states, most assets are divided roughly equally in most cases.<sup>36</sup> Therefore Virginia's choice of dual classification over all property again shows a moderate preference for individualism over sharing.

Moreover, property division in an all property state is a discretionary process. States using the all property model have few fixed rules for property division, and trial judges have great flexibility to reach an equitable result. Unfortunately, the lack of a system of fixed rules for property division reduces the predictability of judicial decisions. Because different trial judges divide property in very different ways, the identity of the trial judge can become the most important variable in the case.<sup>37</sup> Indeed, the same judge may reach different results on essentially the same facts. This unpredictability encourages litigation, discourages settlement, and increases court costs.<sup>38</sup> Dual classification provides a more predictable result because the court cannot divide nonmarital property, but the price of predictability of result is the loss of flexibility in the process. By choosing dual classification over all property, the Virginia General Assembly showed a clear desire that the court's property division be reasonably predictable.

Finally, the all property system is an easy system to administer. Because there are few fixed rules of law, the appellate courts are not burdened with the need to decide difficult legal issues.<sup>39</sup> Similarly, the trial courts

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34. See *id.* § 2.02. For a sample all property statute, see MASS. GEN. LAWS ANN. ch. 208, § 34 (West 1989) ("the court may assign to either the husband or wife all or any part of the estate of the other").

35. See L. GOLDEN, *supra* note 11, § 2.02.

36. *Id.* During my five years as a researcher in the field of equitable distribution, I have confirmed this observation in discussions with many attorneys from all property states.

37. *Id.* Again, I have confirmed this in numerous discussions with attorneys from all property states.

38. *Id.* § 2.02 and appendix A (South Dakota section) (Supp. 1990); see also Schumaker v. Schumaker, 439 N.W.2d 815, 818 (S.D. 1989) (Henderson, J., concurring) (discussing role of contributions to specific assets in all property system, and concluding that undervaluation of such contributions discourages settlement and encourages litigation).

39. See Smith, *supra* note 17, at 729 (describing classification of property in equitable distribution states as "complex and unpredictable").



need not deal with the complexities of classifying property as marital or nonmarital, and can proceed directly to the division stage. Dual classification, on the other hand, is harder to administer because the court must decide difficult legal issues and then apply the resulting rules to fact situations that often are detailed and complex. By enacting a dual classification system, the General Assembly evidenced a willingness to accept some difficulty in administration to reach a more predictable, less discretionary result.

### *B. Perceived Failings of the Prior Law*

The 1990 amendments arose out of a clear sense that the previous law suffered from serious problems. To understand the new amendments fully, we must first understand the problems the General Assembly intended the new amendments to correct.

The salient feature of Virginia law before 1990 was the unitary theory of property.<sup>40</sup> The theory was adopted in *Smoot v. Smoot*,<sup>41</sup> where the court held:

Code § 20-107.3 contemplates only two kinds of property—marital property and separate property, each expressly defined. Our statute does not recognize a hybrid species of property.<sup>42</sup>

Thus, under *Smoot*, a single asset could not have both separate and marital interests. The court was required to classify assets as either all marital or all separate property. Therefore, when property was acquired with both marital and separate funds, one interest had to be submerged beneath the other. The *Smoot* court chose to submerge the separate interest:

[W]hen, as here, a spouse fails to segregate and instead, commingles separate property with marital property, the chancellor must classify the commingled property as marital property subject to equitable distribution.<sup>43</sup>

Accordingly, whenever marital and separate funds were mixed in a single asset, the separate interest transmuted into marital property, even if the respective sizes of the marital and separate interests could be determined easily.

Although *Smoot* defined marital property broadly, the court did not anticipate the equal division of all marital property. Indeed, the court

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40. See generally L. GOLDEN, *supra* note 11, § 5.06A; *Smoot v. Smoot*, 233 Va. 435, 357 S.E.2d 728 (1987).

41. 233 Va. 435, 357 S.E.2d 728 (1987).

42. *Smoot v. Smoot*, 233 Va. 435, 441, 357 S.E.2d 728, 731 (1987).

43. *Id.*

ultimately affirmed an unequal division on the facts.<sup>44</sup> The court in *Smoot* stopped short of requiring an unequal division, leaving the ultimate division of property to the trial court's discretion.<sup>45</sup>

Decisions after *Smoot* developed unitary property in a logical and fair manner. In a number of cases, the Virginia Court of Appeals held that almost any marital contribution was sufficient to transmute separate property into marital property.<sup>46</sup> In keeping with *Smoot* and the general philosophy of the Virginia statute, the Virginia Court of Appeals defined contributions broadly, including not only direct contributions of marital funds,<sup>47</sup> but also indirect contributions of marital efforts.<sup>48</sup> In almost all of these cases, the Virginia Court of Appeals repeated *Smoot's* reminder that transmuted property need not be divided equally.<sup>49</sup> Nevertheless, the ultimate division still depended upon the trial court's discretion. Regardless of whether the trial court divided the property equally or unequally, the trial court's division of property was rarely challenged successfully on appeal.<sup>50</sup>

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44. In *Smoot*, the husband had made a \$25,000 separate property downpayment on a home, and the parties made mortgage payments with marital funds. The trial court found that use of marital funds to pay the mortgage transmuted the entire home into marital property. 233 Va. at 439, 357 S.E.2d at 729. The trial court returned \$25,000 to the husband before dividing the rest of the home equally, and the Virginia Supreme Court affirmed its decision. *Id.* at 440-41, 357 S.E.2d at 730-31.

45. *Smoot*, 233 Va. at 443, 357 S.E.2d at 732; see also *Ellington v. Ellington*, 8 Va. App. 48, 378 S.E.2d 626 (1989) (holding that *Smoot* does not require a specific source of funds credit).

46. See *infra* notes 47-48.

47. See, e.g., *Smoot v. Smoot*, 233 Va. 435, 357 S.E.2d 728 (1987) (separate property downpayment on home transmuted when mortgage payments made with marital funds); *Taylor v. Taylor*, 9 Va. App. 341, 387 S.E.2d 797 (1990) (separate property transmuted when commingled with marital property in joint bank account); *Lassen v. Lassen*, 8 Va. App. 502, 383 S.E.2d 471 (1989) (same); *Holmes v. Holmes*, 7 Va. App. 472, 375 S.E.2d 387 (1988) (same); *Price v. Price*, 4 Va. App. 224, 355 S.E.2d 905 (1987) (separate property gemstone transmuted into marital property when combined with marital property gemstone into new ring).

48. No Virginia case has held that indirect contributions actually caused transmutation. Two decisions recognized the possibility, however, and remanded the case for further factual findings. See *Lambert v. Lambert*, 6 Va. App. 94, 367 S.E.2d 184, 190 (1988) (separate property can transmute where active efforts of either party that are "significant to the marital relationship" cause property to appreciate); *Ellington v. Ellington*, 8 Va. App. 48, 378 S.E.2d 626 (1989) (same).

49. See, e.g., *Ellington*, 8 Va. App. at 54, 378 S.E.2d at 629; *Lambert*, 6 Va. App. at 104, 367 S.E.2d at 190.

50. See *Smoot v. Smoot*, 233 Va. 435, 357 S.E.2d 728 (1987) (awarding husband amount of separate property downpayment on transmuted home, and dividing rest of home equally); *Ellington v. Ellington*, 8 Va. App. 48, 378 S.E.2d 626 (1989) (affirming unspecified source of funds credit less than proportional size of separate contributions; expressly holding that there is no specific credit requirement, and that trial court has discretion to award any equitable amount); *Pommerenke v. Pommerenke*, 7 Va. App. 241, 372 S.E.2d 630 (1988) (giving wife half amount of marital funds used to pay mortgage, and awarding rest of transmuted separate property home to husband; husband received \$102,500, while wife received only \$7500).

The ultimate effect of unitary property, therefore, was to weaken the protection given to separate property. If the *Smoot* court had recognized the separate interest in mixed property, the trial court on remand would have been required as a matter of law to return the separate interest to the owning spouse. Under unitary property, with the entire property classified as marital, the trial court had the discretion either to return the separate interest to the owning spouse or to award the separate interest to both parties. Thus, protection of separate property depended not upon law, but upon the trial court's discretion.<sup>51</sup> This weakening of separate property was the primary perceived flaw with Virginia's pre-1990 equitable distribution law.

A number of related problems arose logically from the discretionary protection standard. First, the discretionary standard made it very difficult for attorneys to predict the court's ultimate property division.<sup>52</sup> This unpredictability discouraged settlement and increased costs of litigation. Second, the discretionary standard inevitably led to inconsistent trial court opinions.<sup>53</sup> Commingled separate assets protected by one judge would be divided by another. The disparate trial court decisions violated the basic equitable principle that similar cases should receive similar treatment. Finally, the degree of protection given to separate property often depended upon a technical analysis of relatively minor amounts of commingling rather than upon the policies behind the statute.<sup>54</sup> This analysis was so counterintuitive and confusing that it impeded rather than assisted the ultimate search for equity. Before taking two steps forward at the division stage, the court had to take one step backward at the classification stage.

Beneath all these problems, however, is a deeper truth. In arguing for statutory revisions, most commentators chose to focus upon procedural flaws, such as unpredictability and inconsistency.<sup>55</sup> None of these problems would have arisen, however, if trial judges had exercised their discretionary authority to protect commingled separate property by making an unequal division. The very existence of procedural complaints, therefore, suggests an underlying substantive failure. Under the unitary property system,

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51. See L. GOLDEN, *supra* note 11, § 5.06A (discussing discretionary protection given to separate assets under unitary theory of property); Turner, *supra* note 1, at 859-60 (same).

52. See Legislative Subcommittee Report, *supra* note 10, at 2 (criticizing "[i]nability to counsel clients on their reasonable property expectations, even in the most simple of equitable distribution cases"); Diehl, *supra* note 10, at 27 ("The inability to provide sound legal guidance to our clients as to their ultimate expectations in the division of marital property upon divorce in Virginia repeatedly has been cited as a current problem in prior published articles").

53. See Legislative Subcommittee Report, *supra* note 10, at 2 (criticizing "inconsistent court results with similar fact situations"); Diehl, *supra* note 10, at 27 ("inconsistent case law has still left practitioners without guidance as to when a 'source of funds' type of credit will be made to the contributing spouse").

54. See Diehl, *supra* note 3, at 32 ("the opinions reward the marital estate due to a 'technical' commingling rather than further the goals of the marital partnership theory").

55. See Diehl, *supra* note 10; Diehl, *supra* note 3; Legislative Subcommittee Report, *supra* note 10.

Virginia trial judges were simply not giving sufficient protection to commingled separate property.<sup>56</sup>

### C. Purposes of the 1990 Amendments

To summarize, therefore, the General Assembly adopted the 1990 amendments to correct several perceived problems with classification of property under previous law. The classification process was viewed as too unpredictable, too inconsistent, too technical, and too far removed from the general policies of equitable distribution. All of these complaints stemmed from two sources: *Smoot's* decision to leave the protection of separate property to the trial court's discretion, and the failure of trial judges to exercise that discretion to consistently protect commingled separate property. During the process of debating and passing the proposed changes, the General Assembly was assured that the modified statute would address each of these points.<sup>57</sup> It is reasonable to assume, therefore, that the General Assembly's overriding intent was to correct these specific perceived failings.

## II. THE MIXED THEORY OF PROPERTY

The primary effect of the new amendments is simple: unitary property is overruled. Section 20-107.3(A) states that there are three kinds of property: separate property, marital property, and property "which is part separate and part marital."<sup>58</sup> The new Virginia statute expressly contemplates the "hybrid species of property" *Smoot* refused to recognize.<sup>59</sup> The rule that property can have both marital and separate interests will be called the *mixed theory of property*.<sup>60</sup>

By recognizing mixed property, the new amendments change the basic nature of marital property interests. Under unitary property, the marital interest was essentially an equitable shadow of legal title.<sup>61</sup> The interest might or might not be present in a given asset, but where it was present, it had the exact same size and shape as the legal title. Under the new

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56. See L. GOLDEN, *supra* note 11, § 5.06A ("By leaving the return of separate property to the unpredictable discretion of the trial judge, unitary property may unduly threaten the concept of separate property"); J. Feldman & C. Fleck, *Taming Transmutation: A Guide to Illinois' New Rules on Property Classification and Division upon Dissolution of Marriage*, ILL. B.J., March 1984, at 336-38 ("The statutory protection given to nonmarital property by dual classification was seriously threatened by the doctrine of [strict] transmutation" required by unitary property).

57. See generally Diehl, "Comments and Analysis of Proposed Amendments to § 20-107.3 Relating to Definition of Marital and Separate Property in Equitable Distribution Proceedings" (hereinafter cited as Legislative Subcommittee Analysis) (attached as an appendix to this article).

58. VA. CODE ANN. § 20-107.3(A).

59. See *Smoot v. Smoot*, 233 Va. 435, 441, 357 S.E.2d 728, 731 (1987).

60. See L. GOLDEN, *supra* note 11, § 5.06 (discussing mixed theory of property).

61. See L. GOLDEN, *supra* note 11, § 5.06A; Turner, *supra* note 1, at 828-29; .

amendment, by contrast, the marital interest is more analagous to an equitable lien.<sup>62</sup> Similar to other liens, under the new amendment the marital interest can extend to all, some, or none of a particular asset.

*A. Measuring the Marital and Separate Interests: The Source of Funds Rule*

1. Deriving the Source of Funds Rule

Although the statute clearly allows an asset to have both marital and separate portions, the statute does not definitively state how to measure the amount of these portions. Only a few provisions address the questions, and these provisions all relate to very specific fact situations.<sup>63</sup>

Outside of these specific fact situations, the statute provides no guidance on measuring the marital and separate portions of an asset. This failure is somewhat surprising, because the drafters' purpose was to recognize fairly both the marital and separate interests in commingled property.<sup>64</sup> As the drafters intended to recognize and protect both of these interests, one would expect to find some rule on how the sizes of these interests should be computed. The statute, however, is entirely silent on the question.

Nevertheless, the history of the amendments and the proceedings of the General Assembly provide relatively clear guidance as to how to measure the marital and separate portions of an asset. In most equitable distribution states, the marital interest is computed under the "source of funds rule."<sup>65</sup> The "source of funds rule provides that when property is acquired with marital and separate funds, the ratio between the marital and separate interests is the ratio between the marital and separate contributions."<sup>66</sup> While the new amendments are not clear on the subject, there

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62. See L. GOLDEN, *supra* note 11, § 5.06; Turner, *supra* note 1, at 828.

63. See VA. CODE ANN. § 20-107.3(A)(1) (dealing with appreciation in and income from separate property); *id.* § 20-107.3(A)(3)(d-e) (dealing with inseparably commingled marital and separate property); *id.* § 20-107.3(G) (dealing with pensions); *id.* § 20-107.3(H) (dealing with personal injury and worker's compensation awards).

64. See Legislative Subcommittee Report, *supra* note 10, at 4.

65. L. GOLDEN, *supra* note 11, §§ 1.07, 5.07, and 5.07A.

66. This was the original statement of the rule in the community property case of Moore v. Moore. See Moore v. Moore, 28 Cal. 3d 366, 368, 618 P.2d 208, 210, 168 Cal. Rptr. 662, 664 (1980) (community interest is "in the ratio that the payments on the purchase price with community funds bear to the payments made with separate funds").

Despite its California origin, the source of funds rule has been rejected in most community property states. See L. GOLDEN, *supra* note 11, §§ 1.06, 1.07 and 5.07A. Instead, most community property states follow the inception of title rule, under which property is acquired when legal title is first received. L. GOLDEN, *supra* note 11, §§ 1.06, 5.07. The source of funds rule has been widely accepted in equitable distribution states, however, see *infra* note 92, and it can now be called the majority rule. See L. GOLDEN, *supra* note 11, § 5.07A; cf. Tibbetts v. Tibbetts, 406 A.2d 70, 76 & n.9 (Me. 1979) (treating source of funds rule as isolated

is evidence that the General Assembly meant to adopt the source of funds rule.

a. Statutory Language

First, the language of the statute is consistent with the source of funds rule. The statute defines separate property as all property "acquired by either party before the marriage," and all property "acquired during the marriage" by gift, inheritance, or exchange.<sup>67</sup> Marital property, by contrast, is all property "acquired by each party during the marriage" which is not separate property.<sup>68</sup>

Under these provisions, the key elements in determining the classification of property are the manner and time of the property's acquisition. The analysis is essentially two-tiered. First, we must determine the manner of acquisition. If the property was acquired by gift, inheritance, or exchange, then the property is separate property, regardless of the time acquisition occurred.<sup>69</sup> Second, if the property was acquired by some other means, we must determine the time of acquisition. If the property was acquired before or after the marriage, it is separate property, and if the property was acquired during the marriage, it is marital property.<sup>70</sup>

These same rules can be applied to measure the marital and separate interests in mixed property. Mixed property should be separate property to the extent it was acquired (1) by gift, inheritance, or exchange at any time, or (2) by other means before or after the marriage.<sup>71</sup> Mixed property should be marital property to the extent it was acquired by other means during the marriage.<sup>72</sup>

From these rules, we can deduce two points about the nature of acquisition. First, the new statute anticipates the existence of mixed property.<sup>73</sup> Since marital and separate property are acquired at different times

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equitable exception to majority inception of title rule).

Equitable distribution states have generally defined the rule as providing that the marital interest is a portion of the total equity in the property equal to the marital contribution divided by the total marital and nonmarital contribution. *See, e.g., Harper v. Harper*, 294 Md. 54, 80, 448 A.2d 916, 929 (1982) (nonmarital interest is "in the ratio of the nonmarital investment to the total nonmarital and marital investment in the property"); *In re Herr*, 705 S.W.2d 619, 624 (Mo. Ct. App. 1986) (ratio between marital and nonmarital interests is "the ratio of marital investment to the total of marital and nonmarital investment in the property"); *Wade v. Wade*, 72 N.C. App. 372, 382, 325 S.E.2d 260, 269 (1985) ("each estate is entitled to an interest in the property in the ratio its contribution bears to the total investment in the property"), *cert. denied*, 313 N.C. 612, 330 S.E.2d 616 (1985). The language in the above cases restates the *Moore* rule. *See supra* (discussing *Moore* rule).

67. VA. CODE ANN. § 20-107.3(A)(1).

68. *Id.* § 20-107.3(A)(2).

69. *Id.* § 20-107.3(A)(1)(ii-iii).

70. *Id.* § 20-107.3(A)(1)(i), (A)(2)(iii).

71. *See id.* § 20-107.3(A)(1)(i-iii) (defining separate property).

72. *See id.* § 20-107.3(A)(1)(i) & (A)(2)(iii) (defining marital property).

73. *See id.* § 20-107.3(A) (recognizing "separate property," "marital property," and property "which is part separate and part marital property").

and in different manners, it must be possible for the same asset to be acquired in more than one way. Otherwise, mixed property would never exist. Second, acquisition cannot mean mere inception of legal title.<sup>74</sup> If this were so, every asset would be acquired in only one manner and at only one time. As noted above, however, the statute clearly anticipates multiple methods of acquisition.<sup>75</sup> If multiple methods are to exist, then acquisition must be more than creation of legal title.

Neither of these points requires use of the source of funds rule, but they are both fully consistent with it. Under the source of funds rule, the ratio of marital and separate contributions is used to measure the marital and separate interests.<sup>76</sup> Because contributions can be made by different means at different times, acquisition is obviously a process rather than an event. This meets the first requirement. In addition, under the source of funds rule, acquisition depends not upon inception of title, but upon the marital and separate contributions of real economic value.<sup>77</sup> The fact that title vested at a particular time does not matter because legal title by itself is not a contribution to value. Thus, the source of funds rule meets both of the statutory requirements outlined above.

Further guidance on measuring the marital and separate interests comes from the provisions of the statute addressing appreciation. It is reasonable to assume that the legislature intended to adopt a single comprehensive theory of marital property. Thus, if we can find a single theory that unites all of the disparate provisions of the Virginia statute, that theory should probably control questions which the statute does not answer directly.

As we shall see, the new amendments adopt the same rule for classifying income and appreciation in separate property. If marital funds or efforts caused the appreciation or income, it is marital property, but if forces outside the marriage caused the appreciation or income, that appreciation or income is separate property.<sup>78</sup> Under this rule, classification of property depends upon its source: the appreciation or income is given the same classification as the funds or efforts which produced it. Moreover, for several years now, pensions have been marital property to the extent pensions were earned during the marriage.<sup>79</sup> Again, the statute looks to

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74. Indeed, the court of appeals rejected an inception of title approach even under unitary property. *Booth v. Booth*, No. 0981-86-3, slip op. at 5 (Va. Ct. App., Feb. 2, 1988). Subsequently the *Booth* opinion was withdrawn for rehearing. When the opinion was reissued, the court deleted the portion dealing with the definition of acquisition on grounds that the issue had not been presented by the appellant. *See Booth v. Booth*, 7 Va. App. 22, 371 S.E.2d 569 (1988). The deleted portion of the opinion, however, is consistent with prior and subsequent cases and provides a valuable insight into the court's thinking.

75. *See supra* notes 67-74 and accompanying text.

76. *See* L. GOLDEN, *supra* note 11, § 5.07A.

77. *See id.*

78. *See* VA. CODE ANN. § 20-107.3(A)(1) (appreciation in separate property); *id.* § 20-107.3(A)(3)(a) (income from separate property).

79. *See id.* § 20-107.3(G).

the source of an asset: pensions that were obtained as compensation for marital efforts are defined as marital property.

The source of funds rule classifies unappreciated property in exactly the same way. Like the statutory provisions on appreciation, income, and pensions, the source of funds rule gives property the same classifications as the underlying contributions that created it.<sup>80</sup> Virginia already applies source of funds principles, therefore, when classifying pensions and appreciation in separate property.

The new statutory rules on appreciation also support the source of funds rule in a second way. The commingling provisions of the new statute provide that when marital and separate funds are mixed, and the contributions are identifiable, neither interest loses its character.<sup>81</sup> Thus, the size of the marital and separate interests must be at least the size of the contributions. If the property then appreciates due to forces outside the marriage, each estate is entitled to the appreciation in its proportional interest.<sup>82</sup> The ultimate result is that the interests are proportional to the contributions of the parties—the exact same result that would be reached under the source of funds rule.

#### b. Legislative History

The General Assembly did not prepare any legislative history materials addressing the new amendment. In presenting its proposed bills to the General Assembly, however, the Family Law Section prepared a detailed analysis that described the major effects of the bill.<sup>83</sup> The analysis was based upon a detailed report submitted by the Section's Legislative Subcommittee,<sup>84</sup> which prepared the first draft of the new amendment. Both documents are attached as appendices to this article. Interested legislators read both documents and relied upon them during discussion and passage of the bills.<sup>85</sup> Thus, at the time of passage, the legislators considered the Family Law Section's submissions to be an authoritative statement of how the bills would affect Virginia law. Because the General Assembly relied upon these documents, the Subcommittee Report and the Family Law

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80. See L. GOLDEN, *supra* note 11, § 5.07A.

81. See VA. CODE ANN. § 20-107.3(A)(3)(d-e) (establishing rules for classifying mixed property if commingling causes "loss of identity"). By implication, if identity is not lost, the marital and separate portions should remain unchanged.

82. When separate property appreciates due to forces outside the marriage, the appreciation remains separate. See VA. CODE ANN. § 20-107.3(A)(1). Because appreciation in marital property does not fall within any express definition of separate property, appreciation must be marital property. See *id.* § 20-107.3(A)(2)(iii).

83. See *supra* note 57 and accompanying text (discussing Legislative Subcommittee Analysis).

84. Legislative Subcommittee Report, *supra* note 10.

85. See Diehl, "An Introduction to Virginia's New Statute on Transmutation and Property Classification in Divorce Suits, at I-4, in *Post-Divorce Modification and Enforcement* (Va. Committee on Continuing Legal Education ed. 1990).



Section analysis are crucial resources for determining what the legislature intended.<sup>86</sup>

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86. There is ample precedent for considering nonlegislative reports to be evidence of legislative intent. Addressing such reports, the leading treatise on statutory construction notes: In the interpretation of such legislation the reports of these committees or commissions are considered valuable aids. Such reports are acceptable interpretive aids under the same rule which justifies the use of legislative committee reports. The legislature is assumed to have adopted the legislation with the same intent evidenced by the commission's report, unless the language of the statute unambiguously indicates to the contrary.

N. SINGER, *Sutherland Statutory Construction* § 48.11 (4th ed. 1984); see, e.g., *Greenhalge v. Town of Dunbarton*, 122 N.H. 1038, 453 A.2d 1295, 1296 (1982) ("the reports of commissions established to prepare or recommend statutory revisions can prove valuable aids in construing a statute").

The above quotation is made in the context of outside committees appointed by the government. The Family Law Section's Legislative Subcommittee was not specifically so appointed, but it is a duly authorized subcommittee of a government agency, the Virginia State Bar Association. See VA. CODE ANN. 54.1-3910 (1988) (establishing Virginia State Bar Association). The final report of a similar private committee established by the General Assembly to study equitable distribution before its enactment has been given some weight by at least one Virginia decision. See *Papuchis v. Papuchis*, 2 Va. App. 130, 341 S.E.2d 829 (1986) (relying on *Report of the Joint Subcommittee Studying Section 20-107 of the Code of Virginia*, H. Doc. No. 21 (1982 Session)). Shortly after the new amendment was passed, the General Assembly provided further evidence that the Family Law Section's views merit serious consideration. See H.J. Res. 57 (1990 Session) (requesting Family Law Section form a committee to study equitable distribution and report back to legislature). The views of the Family Law Section would therefore seem to merit respect similar to that given to the views of private commissions requested by the government to study specific issues.

If an interpreting court gives the views of the Family Law Section any special deference, there could be problems with the general rule that the views of the statutory drafter are not evidence of legislative intent. N. SINGER, *supra*, § 48.12. There is an exception to that rule, however, when the drafter's views were presented to the legislature:

[I]f the draftsman's views were clearly and prominently communicated to the legislature when the bill was being considered for enactment, so as to give reason to believe that legislators' understanding of the bill would have been influenced by the draftsman's communicated views and so as to be visible to others who are concerned to understand the meaning of the act, there is reason to invoke an exception to the general rule and attach weight to the draftsman's views.

*Id.* § 48.12; see, e.g., *American Waterways Operators, Inc. v. United States*, 386 F. Supp. 799, 803-04 (D.D.C. 1974) (construction of act by administrators "who participated in its drafting and directly made known their views to Congress" are of "higher significance" than construction of act by implementing agency, even though construction of act by implementing agency ordinarily receives "great weight"). When the new amendment was being considered, the Family Law Section's views were presented to the General Assembly through the Legislative Subcommittee Report, *supra* note 10, and the Legislative Subcommittee Analysis, *supra* note 57. Thus, even if the Family Law Section is regarded as a private drafter, its views are nonetheless some evidence of legislative intent.

Where the General Assembly changed the language in the initial draft bill submitted by the Family Law Section, of course, the Report and Analysis are not good indicators of the intent of the General Assembly. The mere fact that the legislature changed some sections of the bill, however, see *infra* note 310, indicates that the legislature acted deliberately when it left the remaining portions of the bill unchanged. Where the language was not changed, therefore, the Report and Analysis are some evidence of the legislative intent.

The Legislative Subcommittee Report states clearly that the new amendments adopt the source of funds rule.<sup>87</sup> The official report included the following in its list of legislative goals:

A modification of the "unitary theory" of property classification, by a "source of funds" classification statute which uses a marital partnership theory as its basis.

An articulation of property classification to permit the trial court to classify property based upon the "source of funds" concept which is used in virtually all other common law classification states.<sup>88</sup>

The Family Law Section's analysis likewise anticipates that the source of funds rule will control. After discussing the new rules for classifying untraceable mixtures of marital and separate property, the analysis states:

However, consistent with the "source of funds" theory, if such contributions are "retraceable" by a "preponderance of the evidence," and was [sic] not a gift, then such contributed property shall retain their [sic] original classification, such property *shall* be classified by the trial court as "part separate" and "part marital" based upon the "source of funds" rules well-established by non-Virginia case law.<sup>89</sup>

The explanation also discusses in some detail a hypothetical fact situation involving the purchase of a home.<sup>90</sup> In the hypothetical, the home is purchased with a separate property down payment, and the mortgage is paid off with marital funds. The explanation classified the home as part marital and part separate property, in the same ratio as the marital and separate contributions. This is the exact same result reached by numerous cases applying the source of funds rule.<sup>91</sup>

In sum, the materials presented to the General Assembly make repeated references to source of funds principles. Moreover, the hypothetical fact situations used as examples all reach results consistent with the source of funds rule. The source of funds rule was therefore presented to the legislature as an integral part of the proposed bill. When the General Assembly passed the bill, the General Assembly showed clear intent to adopt the source of funds rule.

### c. Other States

Although decisions from other states cannot control the interpretation of the Virginia statute, those decisions are instructive as to the proper

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87. See *infra* notes 88-91 and accompanying text.

88. Legislative Subcommittee Report, *supra* note 10, at 3-4.

89. Legislative Subcommittee Analysis, *supra* note 57, at 19.

90. See *id.* at 11.

91. See, e.g., *Thomas v. Thomas*, 259 Ga. 73, 377 S.E.2d 666 (1989); *Harper v. Harper*, 294 Md. 54, 448 A.2d 916 (1982); *In re Herr*, 705 S.W.2d 619 (Mo. Ct. App. 1986).

interpretation of the Virginia statute. Most other states follow the source of funds rule.<sup>92</sup> There is reason to believe that the General Assembly knew of this fact because the Legislative Subcommittee's official explanation of the proposed amendments mentioned that the source of funds rule was well-established in other states.<sup>93</sup> Arguably, if the legislators had meant to reject the clear consensus in other states, the General Assembly would have issued an express statement to that effect. Because nothing in the new amendments is inconsistent with the source of funds rule, there is no reason why that rule should not apply.

#### d. Policy Concerns

Finally, the source of funds rule is consistent with the policies behind the Virginia statute. As noted above, Virginia's equitable distribution statute emphasizes individualism over sharing when classifying property as marital or separate.<sup>94</sup> By giving each estate not only its base contribution but also a fair return on its investment,<sup>95</sup> the source of funds rule shows a similar preference for individualism. At the same time, by drawing

92. For decisions adopting the source of funds rule by name, see *Jackson v. Jackson*, 765 S.W.2d 561 (Ark. 1989); *Thomas v. Thomas*, 259 Ga. 73, 377 S.E.2d 666 (1989); *Tibbetts v. Tibbetts*, 406 A.2d 70 (Me. 1979); *Harper v. Harper*, 294 Md. 54, 448 A.2d 916 (1982); *Hoffmann v. Hoffmann*, 676 S.W.2d 817 (Mo. 1984); *Wade v. Wade*, 72 N.C. App. 372, 325 S.E.2d 260 (1985); *Shank v. Shank*, 387 S.E.2d 325 (W. Va. 1989). For decisions adopting general source of funds principles without identifying the principles by that name, see *Gregg v. Gregg*, 474 So. 2d 262 (Fla. Dist. Ct. App. 1986); *Landay v. Landay*, 429 So. 2d 297 (Fla. 1983); *Schmitz v. Schmitz*, 309 N.W.2d 748 (Minn. 1981).

Only two decisions have expressly rejected the source of funds rule: *Smoot v. Smoot*, 233 Va. 435, 357 S.E.2d 728 (1987); *Anthony v. Anthony*, 355 Pa. Super. 589, 514 A.2d 91 (1986). *Smoot*, of course, has been overruled by the new amendment. See *supra* notes 58-60 and accompanying text. *Anthony* was based on an unusual Pennsylvania statute providing that all appreciation in separate property is marital property, regardless of cause. PA. STAT. ANN. tit. 23, § 401(e) (Supp. 1990). Because most other states have no such statute, *Anthony* has little value outside Pennsylvania. Moreover, although Pennsylvania has expressly rejected the source of funds rule, the source of funds rule is probably the only theory which can unify all of the Pennsylvania decisions on the definition of marital property. See generally L. GOLDEN, *supra* note 11, appendix A (Pennsylvania section). Thus, while Pennsylvania has rejected the source of funds rule in theory, Pennsylvania has not actually rejected the rule.

93. See Legislative Subcommittee Analysis, *supra* note 57, at 19 (source of funds rule is "well-established by non-Virginia case law").

94. See *supra* notes 35-36 and accompanying text.

95. See *Tibbetts v. Tibbetts*, 406 A.2d 70, 77 (Me. 1979) ("The marital and non-marital estates have each made investments from which they are entitled to the full benefit and return"); *Harper v. Harper*, 294 Md. 54, 57, 448 A.2d 916, 929 (1982) ("the spouse who contributed nonmarital funds, and the marital unit that contributed marital funds each receive a fair and proportional return on their investment"). Indeed, if the marital estate received only the amount of its contribution and not a return on its investment, "incentive for a sophisticated spouse to divert marital funds into improving his or her separate property thereby depriving the other spouse of any possible return of the marital investment upon the dissolution of the marriage" would exist. *Wade v. Wade*, 72 N.C. App. 372, 380, 325 S.E.2d 260, 268, *cert. denied*, 313 N.C. 612, 330 S.E.2d 616 (1985).

distinctions along marital/separate lines rather than husband/wife lines, the rule also implements principles of sharing. Like the Virginia statute, the source of funds rule balances individualism and sharing, with a slight preference for individualism.

The source of funds rule is also relatively easy to administer. The rule is derived largely from the principle that marital and separate contributions are investments which should receive a proportional share of any appreciation or depreciation in the property involved.<sup>96</sup> This rule is easy to state as a mathematical formula which can be easily applied by judges and lawyers.<sup>97</sup> Moreover, because the rule is grounded in a consistent theory, it can be applied to a wide variety of fact situations. For instance, the Virginia statute already applies versions of the source of funds rule when classifying appreciation in separate property, income from separate property, and retirement benefits.<sup>98</sup> By adopting the source of funds rule, Virginia would adopt a general theory of classification that would help solve many different classification problems.

Finally, the source of funds rule yields a predictable result. Because the rule can be reduced to a simple formula, attorneys can predict with some reliability the size of the marital and separate interests in mixed property.<sup>99</sup> Increased predictability of results will ensure reliable protection for separate property and encourage parties to settle rather than litigate equitable distribution cases. Also, because a majority of state courts follow the source of funds rule, there will be a large body of authority from other states to which attorneys can look for guidance.<sup>100</sup> The presence of this body of authority will ultimately make it much easier to predict how Virginia courts may answer questions of first impression involving equitable distribution. The source of funds rule will thus greatly reduce the unpredictability which plagued Virginia law before the new amendments.

## 2. Applying the Source of Funds Rule

### a. The Basic Source of Funds Formula

The basic premise of the source of funds rule is that the ratio between the marital and separate interests should be the same as the ratio between the marital and separate contributions.<sup>101</sup> This relationship can be expressed as a mathematical formula:

$$\frac{mi}{si} = \frac{mc}{sc}$$

where mi is the marital interest;

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96. See L. GOLDEN, *supra* note 11, § 5.07A.

97. See *infra* notes 100-02 and accompanying text (discussing basic source of funds formula); L. GOLDEN, *supra* note 11, § 5.07A (discussing source of funds formulas generally).

98. See *supra* notes 78-80 and accompanying text.

99. See *supra* notes 100-02 and accompanying text.

100. See L. GOLDEN, *supra* note 11, § 5.07A.

101. See *supra* note 66 and accompanying text.

si is the separate interest;  
 mc is the marital contribution; and  
 sc is the separate contribution.

In addition, the sum of the marital and separate interests must by definition be equal to the total value of the property. Thus:

$$V = mi + si$$

where V is the net value (equity) of the property. Solving these two equations simultaneously for the marital interest, we find the basic source of funds formula:<sup>102</sup>

$$mi = \frac{mc}{mc + sc} \times V$$

Therefore, the marital interest is obtained by multiplying two separate numbers. The first number is the total marital contributions to the property, divided by the total of all marital and separate contributions. The second number is the total value of the property. The formula makes intuitive sense, for the marital interest is the same portion of the total value as the marital contributions are of the total contributions. Thus, if 40% of the contributions are marital, 40% of the total value will be marital.

As the basic source of funds formula shows, the marital and separate interests under the source of funds rule are not at all static.<sup>103</sup> Since the marital interest is a factor of the total value, the marital interest will increase and decrease in size as the property fluctuates in value. The marital and separate interests should therefore be thought of as percentages of total value rather than as absolute amounts.

#### b. Defining Acquisition

So far, we have treated the source of funds rule as simply a method for measuring the marital and separate interests in mixed property. In its full form, however, the rule is much more than a measurement tool. Properly interpreted, the source of funds rule provides the most workable of all basic policy frameworks for implementing the partnership theory of marriage.

This framework arises from the interaction between the source of funds rule and the statutory language. The source of funds rule provides that the marital interest in mixed funds is proportional to the marital and separate contributions.<sup>104</sup> Because the final value of the property will almost always be either more or less than the total contributions, the value of the marital interest will almost always be different from the amount of marital contributions. How can we reconcile this variance with the

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102. See *In re Herr*, 705 S.W.2d 619 (Mo. Ct. App. 1986) (discussing basic source of funds formula); *Mishler v. Mishler*, 90 N.C. App. 72, 367 S.E.2d 385 (1988) (same).

103. See L. GOLDEN, *supra* note 11, § 5.07A.

104. See *supra* note 66 and accompanying text.

statutory requirement that marital property be "acquired by each party during the marriage?"<sup>105</sup>

The source of funds rule answers this question by focusing upon the verb in the statutory sentence: "acquired." Because the marital interest under the source of funds rule fluctuates in size, "acquisition" cannot be a single set event occurring at a specific time. Instead, "acquisition" of marital property is a continuing process: the marital interest increases when new funds are added or when previously contributed funds appreciate, and decreases when previously contributed funds depreciate. In each of these situations, the marital interest increases only proportionally with the value of the asset itself. The conclusion is elegantly simple: property is "acquired" under the source of funds rule whenever real economic value is created.<sup>106</sup>

We can find additional guidance in the statutory definition of separate property. Under the statute, separate property includes three specific types of property: gifts, inheritances, and exchanges.<sup>107</sup> These three types of property share one common characteristic: they were not created by the marital partnership. Combining this common characteristic with the source of funds rule's dynamic definition of acquisition, we can further refine the definition of marital property. Property is acquired during the marriage under the source of funds rule when (1) real economic value is created during the marriage; and (2) the real economic value was a product of the marital partnership.

This dynamic definition of acquisition is the heart of the source of funds rule.<sup>108</sup> By defining acquisition during the marriage as the creation of real economic value by the marital partnership, the source of funds rule reflects financial reality accurately. Classification of property depends not upon arbitrary rules of law, but upon actual objective facts about when and how each individual asset was created. Because of this emphasis

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105. VA. CODE ANN. § 20-107.3(A)(2).

106. See *Harper v. Harper*, 294 Md. 54, 57, 448 A.2d at 916, 929 (1982); *Wade v. Wade*, 72 N.C. App. 372, 325 S.E.2d 860, cert. denied, 313 N.C. 612, 330 S.E.2d 616 (1985).

The reported cases generally define acquisition as the process of paying for newly acquired property. See, e.g., *Harper*, 294 Md. at 80, 448 A.2d at 929 ("acquired" means "on-going process of making payment for property"); *Wade*, 72 N.C. App. at 380-83, 325 S.E.2d at 268-69. Acquisition does not mean payment, however, where property is acquired by means other than purchase. See *Probstein v. Probstein*, 767 S.W.2d 71 (Mo. Ct. App. 1989) (husband received stock during the marriage as additional compensation over and above his salary; stock was acquired during the marriage, and thus marital property, even though stock was never paid for). Thus, the rule that acquisition means payment applies only when property is acquired by purchase.

A more accurate definition of acquisition would be the creation of real economic value. Under this definition, property acquired by purchase is acquired when the price is paid, and property acquired by gift or inheritance is acquired at the time of the transfer. Because this definition applies to all possible means of acquisition, it is a more accurate statement of the general rule.

107. VA. CODE ANN. § 20-107.3(a)(1).

108. See *Harper*, 294 Md. at 70-73, 448 A.2d at 922-25.

upon economics, the source of funds rule implements the partnership theory of marriage more accurately than any other theory of equitable distribution.

c. Property Acquired on Credit

The source of funds rule operates especially well in classifying property acquired on credit. This feature of the rule was presented to the General Assembly directly<sup>109</sup> and was implicitly approved when the General Assembly enacted the proposed bill.

In exploring the rule's treatment of credit, we will use a hypothetical fact situation presented to the legislature.<sup>110</sup> Assume that the husband purchases a \$50,000 home with a \$10,000 separate property down payment. The parties make \$20,000 in mortgage payments during the marriage, and the home is worth \$80,000 on the date of classification.

As with any source of funds question, we must begin by looking at the creation of real value. When existing marital or separate funds are used to purchase property, real value is created immediately. When property is purchased with borrowed funds, however, the exact opposite is true: no real value is created.<sup>111</sup> The purchaser merely has assumed a debt equal to the purchase price of the property, and the purchaser's net worth remains unchanged. At the time of purchase, therefore, property purchased with borrowed funds has no real value, and it has not been acquired for source of funds purposes.<sup>112</sup>

Of course, property purchased with borrowed funds may obtain real value at some point after purchase of the property. When real value exists, one of two things has happened. First, the parties may have used funds to reduce the amount of the lien. In this event, the increased value was acquired in exchange for existing money. The real value should therefore be given the same classification as the assets used to reduce the lien.<sup>113</sup> In our example, \$10,000 of the home was acquired in exchange for the husband's separate property down payment, and \$20,000 was acquired in exchange for the marital funds used to reduce the mortgage. The separate interest is thus at least \$10,000, and the marital interest is at least \$20,000.

This result does not depend in any way upon whether the contributions were payments to the seller or payments to the lender. When the husband used funds borrowed from the bank to pay part of the purchase price,

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109. See Legislative Subcommittee Analysis, *supra* note 57, at 11 (example 10).

110. See *id.*

111. See *Schweizer v. Schweizer*, 301 Md. 626, 484 A.2d 267 (1984); *In re Herr*, 705 S.W.2d 619 (Mo. Ct. App. 1986) (both holding that property purchased on unpaid debt is not "acquired" for source of funds rule purposes).

112. See *Schweizer*, 301 Md. at 627, 484 A.2d at 267.

113. See VA. CODE ANN. § 20-107.3(A)(1)(iii) (property acquired in exchange for separate property is itself separate property).

no real economic value was created.<sup>114</sup> The bank had a lien equal to the amount of the borrowed funds, and the loan did not increase the net value of the property. Real value was created during the marriage only when the parties reduced the lien with marital funds.<sup>115</sup> Under the source of funds rule, therefore, there is no difference between payments of the purchase price and repayments of secured debt.<sup>116</sup> Both are equally valid contributions to the acquisition of property.

So far, the analysis has been relatively simple. The analysis becomes complex, however, when real value is created for the second reason—an increase in the value of the property involved. This increase must be allocated to the marital and separate interests.

The logical way to allocate the appreciation would be to distribute it proportionally to the marital and separate interests at the time of appreciation.<sup>117</sup> Unfortunately, this is impractical. Under the source of funds

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114. See *Schweizer v. Schweizer*, 301 Md. 626, 484 A.2d 267 (1984); *In re Herr*, 705 S.W.2d 619 (Mo. Ct. App. 1986) (both holding that property purchased on unpaid debt has not been "acquired" for source of funds purposes).

115. See *Schweizer*, 301 Md. at 627, 484 A.2d at 267.

116. See L. GOLDEN, *supra* note 11, § 5.07A.

117. See *Thomas v. Thomas*, 259 Ga. 73, 78, 377 S.E.2d 666, 670 (1989) ("Concerning appreciation, if the house is thought of not as a single unit but as two monetary units, one separate and one marital, the analysis is simplified").

This analysis may be a bit oversimplified, for there is actually a third unit involved. The home appreciated in value from \$50,000 on the date of marriage to \$80,000 on the date of valuation. Thus, of the \$80,000 value, \$30,000 represents appreciation, \$10,000 represents separate contributions, and \$20,000 represents marital contributions. Added together, however, these amounts total only \$60,000.

The remaining \$20,000 is the value of the outstanding mortgage on the date of separation. Since the parties have not yet paid off this portion of the mortgage, no real economic value exists, and for source of funds purposes this \$20,000 portion has not been acquired by the parties. In a roughly equitable sense, it is still owned by the bank, to which it would revert if the parties stopped paying the mortgage.

Even though the \$20,000 has not yet been acquired, however, it can still appreciate in value. Thus, there are really three interests here: the marital interest, the separate interest, and the bank's interest. Allocating the appreciation in proportion to the base amounts, we find \$12,000 marital appreciation, \$6000 separate appreciation, and \$12,000 appreciation in the bank's interest. The marital appreciation should obviously remain marital, while the separate appreciation should remain separate (unless it was caused by marital funds or efforts, as discussed *infra* at notes 122-26 and accompanying text).

How should we classify appreciation in the bank's interest? That interest does not truly belong to the bank, for the amount of the mortgage lien never changes. If the parties stopped paying the mortgage, the bank would receive only its base \$20,000 interest. The real economic value of the appreciation in the bank's interest, therefore, belongs to the parties. A few source of funds states have adopted with no discussion variants of the source of funds formula which allocate the appreciation in the bank's interest entirely to one estate or the other. See L. GOLDEN, *supra* note 11, § 5.07A.

Because the appreciation does not come entirely from either the marital or the separate estate, however, most source of funds states would divide it proportionally between them. The marital interest in the overall appreciation therefore equals the marital interest in the marital appreciation, plus the marital portion of the appreciation in the bank's interest. This expression



rule, the marital and separate interests are fluctuating constantly as the parties make contributions to the real value of the property.<sup>118</sup> If appreciation is to be apportioned logically, we would have to measure the marital and separate interests at the exact moment when the property appreciates. At the very least, this raises difficult questions of mathematics that would pose an immense burden on the classification process.<sup>119</sup> At the worst, measuring marital and separate interests at the exact moment of property appreciation would be impossible, because rarely is it possible to determine the exact moment when property appreciates. There is also an element of the absurd to the entire process, for marital and separate property are meaningless terms during the marriage when most property appreciates.<sup>120</sup> Marital and separate interests come into existence only upon divorce, an event usually occurring long after the property has appreciated.

For practical reasons, therefore, no source of funds state applies a purely logical apportionment method. Instead, courts assume that all of

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mathematically reduces to the marital interest in the marital appreciation, computed without reference to the bank's contribution—which is the same source of funds appreciation formula used in the text. Express consideration of the bank's interest therefore does not change the final result.

118. The marital interest actually fluctuates in two different ways. First, since the marital interest is a factor of the total value, the marital interest rises and falls proportionately with the value of the property. This is merely a corollary of the general rule that the marital and separate contributions are investments that should participate in any gain enjoyed or loss suffered by the property as a whole. *See supra* note 102 and accompanying text.

In addition, the marital interest depends upon the total marital and separate contributions, not all of which need be made at the same time. *See infra* notes 133-34 and accompanying text. The percentage marital interest therefore rises as more marital contributions are made, and falls as more separate contributions are made. Only at the time of final classification will the marital and separate interests finally become fixed.

119. For instance, in our hypothetical fact situation, the home appreciated in value by \$30,000 during the marriage. Assume that the marriage lasted for 30 months, and that the home appreciated in value \$1,000 in each month. After the first month of the marriage, the marital contribution would be one \$667 mortgage payment (\$20,000 divided among 30 months), and the separate contribution would be the \$10,000 downpayment. The marital portion would be the marital contributions divided by the total contributions, which would be  $(667/10,667)$  or 6.2 percent. Ideally, therefore, 6.2 percent (\$62) of the first month's appreciation would be marital.

In the second month, the marital contribution would be \$1334 in mortgage payments, plus \$62 in appreciation from the first month, for a total of \$1396. The marital portion would therefore be  $(1396/11,396)$  or 12.2 percent, and \$122 of the second month's appreciation would be marital. An ideal allocation of appreciation would require that this chain of calculations be continued forward for the remaining 28 months of the marriage—a very burdensome task.

Note also that for all the complexity of this example, it is based upon two unrealistically simple assumptions. We assumed that the home appreciated in value evenly through the marriage, even though it probably would have appreciated more in some months than others. We also assumed that the \$20,000 mortgage reduction during the marriage was divided evenly among the 50 months, even though the amount of principal reduction may have been greater in some months than others. In a real case, therefore, the computation would be even more complicated than it was in the above example.

120. *See infra* note 140 and accompanying text.

the appreciation occurred after all of the direct contributions.<sup>121</sup> This technically incorrect assumption simplifies the entire process dramatically. Because the direct financial contributions came first, the court can allocate the appreciation in the same proportions as the marital and separate interests acquired by direct contributions. Thus:

$$mA = \frac{mc}{mc + sc} \times A$$

where A is the total appreciation;

mA is the marital interest in the appreciation;

mc is the direct marital contribution; and

sc is the direct separate contribution.

This formula will be called the source of funds appreciation formula.

In addition, the total marital interest is by definition equal to the direct marital contributions plus the marital interest in the appreciation. In other words:

$$mi = mc + mA$$

where mi is the marital interest. Substituting the first formula into the second, we find:

$$mi = mc + \left( \frac{mc}{mc + sc} \times A \right)$$

Finally, we also know by definition that the direct financial contributions plus the appreciation equal the total value of the property. Thus:

$$mc + sc + A = V$$

where V is the net value (equity) of the property. Solving the last two equations simultaneously, we obtain:

$$mi = \frac{mc}{mc + sc} \times V$$

This is the same basic source of funds formula derived above. By assuming that all of the appreciation occurred before all of the direct contributions, we find that the basic source of funds formula fairly allocates appreciation between the marital and separate interests.

Applying these formulas to our specific fact situation,<sup>122</sup> we find \$10,000 in separate contributions, \$20,000 in marital contributions, and \$30,000 in appreciation. The ratio of marital to separate contributions is two to one, so that 67 percent of all the contributions are marital. Under the source of funds appreciation formula, the \$30,000 appreciation can be allocated as \$20,000 appreciation in the marital interest and \$10,000 appreciation in the separate interest. The marital interest would be \$20,000 in direct contributions plus \$20,000 in appreciation, or \$40,000. The separate interest would be \$10,000 direct contributions plus \$10,000 appreciation, or \$20,000. Using the basic source of funds formula, the

121. See L. GOLDEN, *supra* note 11, § 5.07A.

122. See *supra* notes 109-10 and accompanying text.

marital interest would be 67 percent of the \$60,000 total equity, or \$40,000. The separate interest would be 33 percent of the total equity, or \$20,000. Both formulas yield the same ultimate result.<sup>123</sup>

Accordingly, in most cases, the basic source of funds formula fairly allocates both the direct contributions and the appreciation. There is one situation, however, in which the longer analysis must be used. The basic source of funds formula assumes that none of the appreciation in the property was caused by marital funds or efforts. Thus, appreciation in the separate interest would remain separate, while appreciation in the marital interest would remain marital.<sup>124</sup> In some cases, however, the separate interest may appreciate because of marital funds or efforts. Such appreciation is not caused by the making of mortgage payments with marital funds because mortgage payments do not increase the value of an existing interest.<sup>125</sup> Instead, mortgage payments cause an entirely new interest to be acquired, which is given the same classification as the funds used to pay the mortgage.<sup>126</sup>

In other situations marital funds or efforts may cause appreciation in the existing separate interest. For example, if the parties buy an old home with separate funds and then use marital efforts to rehabilitate it, the marital contribution may cause appreciation in the separate interest. On these facts, the basic source of funds formula will not work because that formula assumes that all appreciation in separate property is separate. Appreciation in separate property is marital property, however, when the appreciation is caused by marital funds or efforts.<sup>127</sup> The court should therefore divide the appreciation into marital and separate components, using the source of funds appreciation formula.<sup>128</sup> The marital interest would then be equal to the direct marital contributions, plus the marital share of the appreciation, plus any part of the separate share of the appreciation which was caused by marital funds or efforts. In our hypothetical fact situation, the marital interest would be \$20,000 in direct

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123. Under both formulas, only the \$60,000 equity in the home is allocated, even though the home is worth \$80,000. This is not inequitable. The party who receives the home will receive \$20,000 of extra property, but that party will also be burdened with a \$20,000 mortgage. In terms of real economic value, therefore, the extra \$20,000 does not exist. The source of funds rule has fairly allocated all of the real economic value, leaving behind only equal amounts of property and secured debt.

124. VA. CODE ANN. § 20-107.3(A)(1).

125. See *Thomas v. Thomas*, 259 Ga. 73, 78, 377 S.E.2d 666, 670 (1989) (mortgage payments created additional marital equity; "[t]he only material cause for the remaining appreciation . . . was outside market forces"; thus, the mortgage payments were not a cause of any appreciation occurring in the separate portion of the home); *Willis v. Willis*, 86 N.C. App. 546, 549, 358 S.E.2d 571, 573 (1987).

126. See *Thomas*, 259 Ga. at 73, 377 S.E.2d at 666; *Willis*, 86 N.C. App. at 546, 358 S.E.2d at 571.

127. See VA. CODE ANN. § 20-107.3(A)(1).

128. See L. GOLDEN, *supra* note 11, § 5.07A; Sharp, *The Partnership Ideal: Development of Equitable Distribution in North Carolina*, 65 N.C.L. REV. 195, 219 n.130 (1987).

financial contributions, plus \$20,000 appreciation in the marital portion, plus that part of the \$10,000 appreciation in the separate portion which was caused by marital funds or efforts.

#### d. Defining Contributions

The definition of contribution under the source of funds rule is mostly a matter of common sense. Any direct payment of consideration to the seller clearly constitutes a contribution. Similarly, when borrowed funds were used to pay the consideration, any payment of principal on the debt constitutes a contribution.<sup>129</sup>

If a payment is neither direct consideration nor repayment of principal on a debt incurred to pay consideration, it is probably not a contribution.<sup>130</sup> For example, payments of interest on a debt are ordinarily not contributions, even when the debt was incurred to purchase the property involved.<sup>131</sup> Tax payments<sup>132</sup> and attorney's fees<sup>133</sup> also are not contributions to the acquisition of property.

In valuing premarital contributions, the court should not use the base amount of the contribution. The contribution may have appreciated before the marriage, and such appreciation is separate property.<sup>134</sup> The court should instead value the separate contribution at its worth on the date of marriage,<sup>135</sup> thus giving the owner the full benefit of his premarital appreciation. For instance, if a home doubles in value after a premarital down payment but before the marriage, the separate contribution should be the equity in the home on the date of marriage, and not the amount of the down payment.

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129. See, e.g., *Schweizer v. Schweizer*, 301 Md. 626, 484 A.2d 267 (1984); *In re Herr*, 705 S.W.2d 619 (Mo. Ct. App. 1986).

130. See *In re Moore*, 28 Cal. 3d 366, 372, 618 P.2d 208, 211, 168 Cal. Rptr. 662, 665 (1980) ("The value of real property is generally represented by the owners' equity in it, and the equity value does not include finance charges or other expenses incurred to maintain the investment. Amounts paid for interest, taxes, and insurance do not contribute to the capital investment and are not considered part of it").

131. See *In re Moore*, 28 Cal. 3d 366, 618 P.2d 208, 168 Cal. Rptr. 662 (1980); *Blake v. Blake*, 81 Md. App. 712, 569 A.2d 724 (1990); *In re Herr*, 705 S.W.2d 619 (Mo. Ct. App. 1986).

132. See *In re Moore*, 28 Cal. 3d 366, 618 P.2d 208, 168 Cal. Rptr. 662 (1980); *Gravenstine v. Gravenstine*, 58 Md. App. 158, 472 A.2d 1001 (1984) (property taxes not contributions to acquisition of property involved).

133. See *In re Click*, 169 Ill. App. 3d 48, 523 N.E.2d 169 (1988), *appeal denied*, 122 Ill. 2d 571, 530 N.E.2d 241 (1988) (funds spent to defend spouse from criminal charges were not contributions; decided under Illinois' unique reimbursement statute, ILL. ANN. STAT. ch. 40, para. 503(c) (Smith-Hurd Supp. 1989), which follows some source of funds principles); *Rickard v. Rickard*, 691 S.W.2d 391 (Mo. Ct. App. 1985) (use of marital funds to pay attorney to defend inheritance in contested will was not contribution to acquisition of inheritance).

134. See VA. CODE ANN. § 20-107.3(A)(1).

135. See, e.g., *Mishler v. Mishler*, 90 N.C. App. 72, 367 S.E.2d 385, *cert. denied*, 323 N.C. 174, 373 S.E.2d 111 (1988).

### e. Partial Sales and Withdrawals

The source of funds rule provides a workable way of measuring the marital and separate interests in assets acquired with both marital and separate contributions. If the entire asset is sold or exchanged, the parties' interests in the consideration are the same as their interest in the conveyed property. Often, however, the parties will convey less than the entire asset. This happens most frequently when the parties withdraw some but not all of the funds in a joint bank account.

How does the court determine whether a partial sale or withdrawal comes from the marital or separate interest? The first step is to look at the intent of the parties. If there is evidence of intent that the withdrawal come from a particular interest, the court should respect that intent.<sup>136</sup> Aside from contemporaneous statements, the best evidence of intent may be the purpose for the withdrawal. Withdrawals for a family purpose are probably from the marital interest,<sup>137</sup> while withdrawals to maintain separate property are generally from the separate interest.<sup>138</sup>

Sometimes, however, there will be no clear evidence of intent. In such cases, courts have come to different results. Some courts have held that the marital funds are withdrawn first.<sup>139</sup> Other courts have held that the withdrawals come proportionally from the marital and separate interests.<sup>140</sup> Because the best answer to this question might vary from case to case, it would be a mistake to apply a single rule to all fact situations.<sup>141</sup>

### f. Date of Classification: The Status of *Wagner*

Under the source of funds formula, all marital and separate contributions count in determining the marital interest, regardless of when the

136. See, e.g., *Wadlow v. Wadlow*, 200 N.J. Super. 372, 491 A.2d 757 (App. Div. 1985) (funds were separate based on parties' intent); *McKinley v. McKinley*, 496 S.W.2d 540 (Tex. 1973) (where interest on separate funds was marital, withdrawal exactly equal to annual interest was intended to come from marital property).

137. See *Beam v. Bank of America*, 6 Cal. 3d 12, 490 P.2d 257, 98 Cal. Rptr. 137 (1971); *See v. See*, 64 Cal. 2d 778, 415 P.2d 776, 51 Cal. Rptr. 888 (1966); see generally J. Oldham, *Tracing, Commingling and Transmutation*, 23 FAM. L.Q. 219, 224-26 (1989).

138. See *Blaine v. Blaine*, 63 Ariz. 100, 159 P.2d 786 (1945); *Pollock v. Pollock*, 7 Wash. App. 394, 499 P.2d 231 (1972).

139. See, e.g., *Allen v. Allen*, 584 S.W.2d 599 (Ky. Ct. App. 1979); *Brown v. Brown*, 72 N.C. App. 332, 324 S.E.2d 287 (1985). This is the traditional community property rule. See, e.g., *Harris v. Ventura*, 582 S.W.2d 853 (Tex. Civ. App. 1979).

140. See *Lampton v. Lampton*, 721 S.W.2d 736 (Ky. Ct. App. 1986) (finding that when parties owned stock that was both marital and nonmarital property, gift to third party came from marital and separate estate in proportions equal to parties' respective interests in stock).

141. For instance, while proportional allocation might in many cases be the fairest method, it would also be the hardest method to apply. In order to use proportional allocation, the court would have to determine the exact sizes of the marital and separate interests every time a partial sale or withdrawal was made, a task which would be quite burdensome in the case of an active bank account. Balancing the benefits and burdens of proportional allocation would seem to require a case-by-case analysis. See Oldham, *supra* note 137, at 221-33 (discussing problem of balancing benefits and burdens of proportional allocation, focusing primarily upon community property states).

contributions are made. For instance, if an asset is acquired partly before and partly after the marriage, both the marital and separate contributions count in determining the marital interest, even though the contributions are made at different times.<sup>142</sup>

This same principle also applies to different types of marital and separate contributions. Assume, for example, that an asset is acquired with three different monetary contributions: \$10,000 in separate funds, \$5,000 in marital funds, and another \$20,000 in marital funds. Each contribution is made at a different time. To determine the marital interest, the court should add up all of the different marital and separate contributions and use them in the basic source of funds formula. The order in which the contributions were made should have no effect upon the marital interest.<sup>143</sup>

Because all contributions count equally, regardless of which were made first, the marital interest can vary over time. In the previous example, for instance, the separate interest would have been 100 percent if the parties had been divorced before the marital contributions were made. If the parties had been divorced between the marital contributions, the marital interest would have been  $(\$5,000 / (\$10,000 + \$5,000))$ , or 33 percent. Finally, if the parties were divorced after all the contributions had been made, the marital interest would be  $((\$20,000 + \$5,000) / (\$10,000 + \$5,000 + \$20,000))$ , or 71 percent. Because marital contributions can be made at any time, the percentage marital and separate interests will vary during the marriage.

Before 1990, Virginia held that the marital interest could not decrease in size during the marriage. In *Wagner v. Wagner*,<sup>144</sup> the parties purchased property using funds borrowed from the wife's parents. The parents then forgave the debt, intending to make a gift to the wife alone. The Virginia Court of Appeals held that property had to be classified immediately upon acquisition.<sup>145</sup> The property was marital property immediately upon its acquisition because the debt had not yet been forgiven. The subsequent forgiveness of the debt, the court held, could not convert marital property into separate property.<sup>146</sup>

*Wagner* is overruled by the new amendments. This conclusion can be seen most clearly in one of the hypothetical fact situations presented to the legislature.<sup>147</sup> Assume that the husband makes a \$10,000 down payment on a home before the marriage. During the marriage, the parties make 40 payments of \$500 each toward the principal balance on the mortgage, for

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142. See *Harper v. Harper*, 294 Md. 54, 448 A.2d 916 (1982); *Wade v. Wade*, 72 N.C. App. 372, 325 S.E.2d 260, cert. denied, 313 N.C. 612, 330 S.E.2d 616 (1985).

143. See *Harper v. Harper*, 294 Md. 54, 448 A.2d 916 (1982); *Wade v. Wade*, 72 N.C. App. 372, 325 S.E.2d 260, cert. denied, 313 N.C. 612, 330 S.E.2d 616 (1985).

144. 4 Va. App. 397, 358 S.E.2d 407 (1987).

145. *Wagner v. Wagner*, 4 Va. App. 397, 404, 358 S.E.2d 407, 410 (1987).

146. *Id.*

147. See Legislative Subcommittee Analysis, *supra* note 56, at 11 (example 10).

a total of \$20,000 in marital contributions. The house is worth \$80,000 on the date of valuation. If *Wagner* were still the law, the home would have to be classified as marital or separate property immediately upon its acquisition. Because the house was acquired before the marriage, the house would be entirely separate property. *Wagner* could be interpreted to require classification as of the first marital contribution, but that also yields an unjust result, because the first marital contribution was the first \$500 mortgage payment. Classification as of that time would give only a 1.67 percent marital interest ( $\$500 / \$30,000$ ). The legislature was told, however, that marital interest would be the total marital contributions over the total of all contributions—( $\$20,000 / \$30,000$ ), or 66.67 percent.<sup>148</sup> This result can be reached only if *Wagner* is disregarded and the property is classified as of the date of divorce.

There are other compelling reasons why *Wagner* should be abandoned. The case never made much sense to begin with, because marital and separate property cannot exist before a divorce decree is rendered.<sup>149</sup> The property involved in *Wagner* could not have been either marital or separate property immediately upon its acquisition, because there was no guarantee that the parties would ever divorce. Obviously, if the marriage had lasted until one party died, there would never have been any marital or separate property. *Wagner* is in fact the only equitable distribution case ever to adopt the inflexible rule that property must be classified immediately upon acquisition. Such an unusual and arbitrary rule should not be adopted absent the mandate of express statutory language.

In addition, *Wagner* placed significant weight upon the court's belief that marital property cannot transmute into separate property. Under the new statute, marital property can transmute into separate property.<sup>150</sup> The new amendments therefore remove an important element of the court's rationale.

Finally, the *Wagner* holding is poor public policy. By classifying property immediately upon acquisition, *Wagner* made the first contribution disproportionately important in relation to later contributions.<sup>151</sup> There is

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148. *Id.*

149. See VA. CODE ANN. § 20-107.3(A) (allowing equitable distribution only upon or after decree of divorce); *Parra v. Parra*, 1 Va. App. 118, 336 S.E.2d 157 (1985) (court cannot make equitable distribution before granting divorce decree). Because classification of property as marital or separate has no effect unless the marriage ends in divorce, classifying property while the marriage is still viable is meaningless. See, e.g. *In re Olson*, 96 Ill. 2d 432, 451 N.E.2d 825 (1983); *In re Schwartz*, 131 Ill. App. 3d 351, 475 N.E.2d 1077 (1985). For further criticism of *Wagner*, see L. GOLDEN, *supra* note 11, appendix A (Virginia section) (criticizing *Wagner*).

150. VA. CODE ANN. § 20-107.3(A)(3)(e) (contemplating in some cases that marital property can transmute into separate property).

151. Under *Wagner*, because the process of acquisition begins with the first contribution, the first contribution largely determines whether the asset will be marital or separate. 4 Va. App. at 404, 358 S.E.2d at 410. Thus, if two equal contributions are made, one marital and one separate, the order of the contributions is crucial. If the marital contribution is made

no logical reason for such a rule. A \$10,000 contribution made in the first year of marriage is no more and no less valuable than a \$10,000 contribution made in the last year of marriage. The clear overriding theme of the new amendments is that all contributions should be treated equally, and that contributions should retain their basic classification as long as the contributions can be traced reasonably.<sup>152</sup> *Wagner* prevents tracing of some contributions by requiring the court to classify the property before all the contributions are made. Because all contributions must now be recognized and given equal weight, *Wagner* is clearly inconsistent with the new amendments.

### *B. Changing the Marital and Separate Interests: The Doctrine of Transmutation*

The doctrine of transmutation provides that under certain circumstances, property can change from one classification to the other.<sup>153</sup> Before the new amendments, the Virginia decisions identified two common fact situations in which transmutation occurs. First, when a mixture of marital and separate property cannot be separated into its component parts, the entire mixture transmutes into marital property.<sup>154</sup> This type of transmutation will be called transmutation by commingling. Second, when the parties intend that separate property become marital, they have in essence made a gift of the separate property to the marital estate.<sup>155</sup> This type of transmutation will be called transmutation by implied gift.<sup>156</sup>

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first, the asset is marital property; and if the separate contribution is made first, the asset is separate property.

152. See generally Legislative Subcommittee Analysis, *supra* note 57.

153. See generally L. GOLDEN, *supra* note 11, § 5.33; Turner, *supra* note 1, at 837-45.

154. See, e.g., *Smoot v. Smoot*, 233 Va. 435, 357 S.E.2d 728 (1987).

155. See, e.g., *Westbrook v. Westbrook*, 5 Va. App. 446, 364 S.E.2d 523 (1988).

156. Accord L. GOLDEN, *supra* note 11, § 5.33. Other commentators refer to the concept by different names. See Krauskopf, *Classifying Marital and Separate Property—Combinations and Increase in Value of Separate Property*, 89 W. VA. L. REV. 997, 1003 (1987) (transmutation by intent); Oldham, *supra* note 137, at 233 (1989) (transmutation by agreement).

Transmutation by agreement is a misleading label because it implies that both spouses must consent to the change in character. As Oldham himself notes, however, "the consent of the spouse losing the [separate] interest in the property is the focus." Oldham, *supra* note 137, at 235. Moreover, transmutation by agreement also implies that transmutation requires an enforceable written agreement, a position which Virginia should reject. See *infra* note 171 and accompanying text.

It is much harder to choose between transmutation by intent and transmutation by implied gift. Transmutation by intent focuses upon the key element of the doctrine, and is therefore probably the most accurate label. In addition to being accurate, however, a label should remind us of the statutory basis for the rule. Transmutation by intent does not meet this requirement, since the classification provisions of the Virginia statute look almost exclusively to the time and manner of acquisition. Nothing on the face of the statute suggests that the parties' intent should be considered.

The statute does provide, however, that property loses its classification if it is given to another estate. VA. CODE ANN. § 20-107.3(A)(3)(d-e). This gift language provides a statutory



The same two types of transmutation can be found in the language of the new amendments. The new transmutation rules provide that property retains its original classification "to the extent [it] is retraceable by a preponderance of the evidence and was not a gift."<sup>157</sup> Inverting this statement, property loses its classification if either (1) it is not retraceable, or (2) it was a gift. The first alternative is essentially transmutation by commingling, while the second alternative is essentially transmutation by implied gift.

Although the two-pronged basic structure of transmutation still exists under new amendments, the shape of the prongs is changed substantially. The largest changes are in the definition of transmutation by commingling. Because under unitary property principles a single asset could have only one classification, all mixtures of marital and separate property were inseparable as a matter of law.<sup>158</sup> Whenever marital and separate property were mixed, therefore, the separate interest transmuted automatically into marital property.<sup>159</sup>

Under the new amendments, a single asset can have both marital and separate interests.<sup>160</sup> Accordingly, mixtures of marital and separate property are no longer automatically inseparable. Instead, the court must attempt to determine the amount of the marital and separate contributions. If these amounts can be determined, the court must apply the source of funds rule and classify the asset as part marital and part separate property.<sup>161</sup>

There will still be fact situations in which a mixture of marital and separate property cannot be identified. Most married couples simply do not keep their financial records with divorce in mind. When the court cannot reasonably determine the amount of the marital and separate contributions, there must be a default rule which instructs the court as to how to classify the property. Thus, while the new amendments restrict transmutation by commingling to cases in which the marital and separate interests cannot be measured reliably,<sup>162</sup> the doctrine has not been abolished.

In addition to restricting the circumstances under which property transmutes by commingling, the new amendments also change the doc-

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basis for classifying property according to the parties' intent. Thus, while transmutation by intent focuses somewhat better upon the substantive content of the doctrine, transmutation by implied gift focuses more upon the statutory basis. In order to emphasize that the doctrine remains viable even under the new amendments, I have chosen to use transmutation by implied gift in this article. Both labels, however, are consistent with the basic elements of the doctrine.

157. VA. CODE ANN. § 20-107.3(A)(3)(d-e).

158. See *Smoot*, 233 Va. at 435, 357 S.E.2d at 728; *Taylor v. Taylor*, 9 Va. App. 341, 387 S.E.2d 797 (1990).

159. *Smoot*, 233 Va. at 435, 357 S.E.2d at 728.

160. VA. CODE ANN. § 20-107.3(A).

161. See generally *supra* notes 101-35 and accompanying text (describing the source of funds rule).

162. VA. CODE ANN. § 20-107.3(A)(3)(d-e).

trine's substantive effect. Under unitary property law, all inseparable mixtures of marital and separate property were classified as marital.<sup>163</sup> Under the new amendments, the result depends upon which contributions were made first. If transmutation occurred when funds of one character were mixed with an existing asset of the opposite character, the mixture is given the same classification as the existing asset.<sup>164</sup> Thus, where marital funds are inseparably mixed with existing separate property, the marital funds transmute into separate property. When a court is unable to determine which asset existed first, the mixture is entirely marital property.<sup>165</sup>

The new version of transmutation by commingling is not entirely satisfactory. As noted above, all contributions to the marital partnership receive equal weight, regardless of the time at which the contributions were made.<sup>166</sup> Under the new amendments, however, when the marital and separate interests cannot be measured, the entire asset is given the character of the first contribution made.<sup>167</sup> If marital funds are mixed with a preexisting separate asset, for instance, the mixture is separate, because the separate interest came first. Conversely, if separate funds are mixed with a preexisting marital asset, the mixture is marital, even if the values of the property involved are the same as in the previous example. These rules violate Virginia's general presumption in favor of marital property.<sup>168</sup> The amendments would have done better to continue the previous rule that property is entirely marital when marital and separate interests cannot be identified.

This is not, however, a major problem. Because transmutation by commingling applies only when the marital and separate interests cannot be measured,<sup>169</sup> mixed property will be classified under the source of funds rule in the large majority of cases. Mixed property transmutes into the character of the first-in-time contribution only when there is insufficient evidence to apply the source of funds rule.<sup>170</sup> If a court dislikes the result under the somewhat arbitrary first-in-time rule, the court can likely find enough evidence to measure the marital and separate interests. The new law on transmutation by commingling is therefore unlikely to cause significant problems.

The new amendments do not change the doctrine of transmutation by implied gift. The amendments state clearly that contributed property retains

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163. See *Smoot v. Smoot*, 233 Va. 435, 357 S.E.2d 728 (1987).

164. VA. CODE ANN. § 20-107.3(A)(3)(d).

165. *Id.* § 20-107.3(A)(3)(e).

166. See *supra* notes 151-52 and accompanying text.

167. VA. CODE ANN. § 20-107.3(A)(3)(d).

168. See *id.* § 20-107.3(A)(2) ("All property [acquired by either spouse during the marriage] is presumed to be marital property in the absence of satisfactory evidence that it is separate property").

169. *Id.* § 20-107.3(A)(3)(d) (property retains its original classification when contribution to property is retraceable by a preponderance of the evidence).

170. *Id.*

its original classification if it is not retraceable "and was not a gift."<sup>171</sup> If the contribution was a gift, therefore, it becomes part of the estate to which it was given. Moreover, no particular formalities are required, and a simple expression of donative intent would probably be sufficient to change the character of an asset.<sup>172</sup> Therefore, transmutation by implied gift is still a viable doctrine under the new amendments.

### C. *Appreciation of the Separate Interest: The Active Appreciation Rule*

The heart of the new amendments is a fairly specific set of rules on classifying appreciation in separate property.<sup>173</sup> Often appreciation in separate property is caused by marital contributions, and the basic philosophy of the new amendments is that all property traceable to a marital source should constitute marital property.<sup>174</sup> Since Virginia now follows the mixed theory of property, there must be a method for measuring the respective marital and separate interests in appreciated separate property.

The method set forth in the new amendments is easily stated. The statute provides:

The increase in value of separate property during the marriage is separate property, unless marital property or the personal efforts

171. *Id.* § 20-107.3(A)(3)(d-e).

172. For instance, in *Westbrook v. Westbrook*, 5 Va. App. 446, 364 S.E.2d 523 (1988), the parties used borrowed funds to build a home on the husband's separate property real estate. The wife allowed use of her credit only after the husband signed a written statement that they owned a separate property home "together." The agreement was not sufficient to transfer legal title because of the Statute of Frauds. Nevertheless, the court found sufficient evidence of an implied gift, and held that the home transmuted into marital property.

Because the court's rationale did not depend upon any commingling of marital and separate funds, nothing in *Westbrook* is inconsistent with the new amendments. Indeed, strong policy reasons support the *Westbrook* decision. Virginia has a strong public policy of enforcing the agreements of the parties in divorce cases. *See* VA. CODE ANN. § 20-107.3(I) (addressing agreements between parties control over contrary language in equitable distribution statute). By enforcing such agreements, courts follow the parties' own expectations, reduce litigation costs, and encourage future settlements. These policy reasons apply to implied gifts as well as enforceable contracts. Transmutation by implied gift "combines the advantages of administrative efficiency with reaching results intended by the parties, thereby enhancing settlement possibilities." Krauskopf, *supra* note 156, at 997, 1003.

Courts should make certain, of course, that the expression of donative intent was serious and legitimate. In *Westbrook*, for example, the husband's statement of intent was made deliberately after arm's-length negotiations in which he received a substantial benefit (the wife's credit). 364 S.E.2d at 525-26. Where the expression of intent is not so deliberate, transmutation might not occur. Where donative intent clearly exists, however, it should be enforced even if there was no formal enforceable agreement. Requiring a formal agreement would work a substantial injustice, for married couples often reach informal understandings on use and ownership of their property. As long as the owning spouse's consent was genuine, these arrangements should be enforced, even if there was no formal written agreement. The Statute of Frauds has no place in the law of transmutation by implied gift.

173. VA. CODE ANN. § 20-107.3(A)(1).

174. *See supra* notes 63-100 and accompanying text.

of either party have contributed to such increases and then only to the extent of the increases in value attributable to such contributions. The personal efforts of either party must be significant and result in substantial appreciation of the separate property if any increase in value attributable thereto is to be considered marital property.<sup>175</sup>

Thus, the general rule is that appreciation in separate property remains separate. The appreciation is marital property, however, if several factors are present. First, there must have been marital contributions to the property.<sup>176</sup> A marital contribution for this purpose is either any amount of marital funds, or any "significant" amount of marital efforts.<sup>177</sup> Second, the separate property involved must have appreciated, and to the extent marital efforts are involved, the appreciation must be "substantial."<sup>178</sup> Finally, there must be a causal connection between the marital contributions and the appreciation.<sup>179</sup> If all these requirements are met, the appreciation is "active," and the appreciation constitutes marital property.<sup>180</sup> If the requirements are not met, the appreciation is "passive," and it remains separate property.<sup>181</sup>

### 1. Marital Contributions

Under the statute, there are two types of marital contributions: marital property and personal efforts.<sup>182</sup> Contributions of marital property most commonly consist of marital funds. Note that there is no minimum amount of property that must be contributed, and no minimum amount of appreciation that must result. Even small amounts of appreciation are marital if they were caused by direct financial contributions.

The law on personal effort is not as clear. The statute defines "personal effort" broadly:

"Personal effort" of a party shall be deemed to be labor, effort, inventiveness, physical or intellectual skill, creativity or managerial activity, promotional or marketing activity, applied directly to the separate property of either party.<sup>183</sup>

This definition includes almost every conceivable effort which could be used to increase the value of separate property. Moreover, the statute

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175. VA. CODE ANN. § 20-107.3(A)(1).

176. *Id.*

177. *Id.*

178. *Id.*

179. *Id.*

180. See generally L. GOLDEN, *supra* note 11, § 5.39; Krauskopf, *supra* note 156, at 1013-37. Almost all dual classification equitable distribution states recognize the distinction between active and passive appreciation.

181. See generally L. GOLDEN, *supra* note 11, § 5.39.

182. VA. CODE ANN. § 20-107.3(A)(1).

183. *Id.* § 20-107.3(A)(3)(e).

states that the personal effort of "either" the owning or the nonowning spouse can create active appreciation.<sup>184</sup>

"Personal effort" is qualified, however, in two ways. The personal effort must be "significant," and the amount of appreciation must be "substantial."<sup>185</sup> The statute does not in any way define these terms. As both terms were enacted from a similar Illinois statute,<sup>186</sup> however, a workable definition can be derived from the case law under that statute.<sup>187</sup>

To begin with, we should understand the purpose of the "significant" personal effort and "substantial" appreciation requirements. The limitations were not intended to provide any arbitrary lower limit upon the amount of personal effort which is judicially recognizable. If only a small amount of personal effort is contributed, then there will be only a small amount of active appreciation.<sup>188</sup> One of the important strengths of the mixed theory of property is that the court can reward small contributions with equally small marital interests.<sup>189</sup> This benefit would be lost if the statute were read to apply only to objectively "large" marital contribu-

184. *Id.* § 20-107.3(A)(1).

185. *Id.*

186. ILL. ANN. STAT. ch. 40, para. 503(c) (Smith-Hurd Supp. 1990). On its face, the Illinois statute is very different from the Virginia statute, because the Illinois statute defines active appreciation as separate property. *Id.* para. 503(a)(7). In addition, however, the statute also gives the marital estate an equitable right of reimbursement equal to the amount of appreciation caused by marital contributions. *Id.* para. 503(c)(2). As in Virginia, if the contributions are of personal effort, the effort must be significant and the appreciation must be substantial. *Id.* para. 503(c)(2). The end result, therefore, is that active appreciation is essentially marital property. See L. GOLDEN, *supra* note 11, § 5.34 (Supp. 1990) (criticizing complicated statutory scheme of Illinois).

187. Although the Illinois case law is certainly relevant, it is not by any means dispositive. There are, in fact, a number of relevant differences between the Virginia and Illinois statutes. First, the Virginia statute contains a very broad definition of personal effort. VA. CODE ANN. § 20-107.3(A)(3)(c). This provision has no counterpart in the Illinois statute, and the Illinois cases may define personal effort more narrowly than the Virginia legislature intended. Second, the burden of proof under the Illinois statute is clear and convincing evidence, while the burden of proof under the Virginia statute is a preponderance of the evidence. Compare ILL. ANN. STAT. ch. 40, para. 503(c) with VA. CODE ANN. § 20-107.3(A)(1). Finally, the Illinois statute clearly requires reimbursement for all contributions of marital funds, regardless of whether the property involved appreciated. See *In re Adams*, 183 Ill. App. 3d 296, 538 N.E.2d 1286 (1989). The Virginia statute, by contrast, recognizes a marital interest from contributions of marital funds only if the property appreciated. VA. CODE ANN. 20-107.3(A)(3). A different result might occur if contributions of marital funds constitute partial acquisitions of property under the source of funds rule. See *supra* notes 102-35 and accompanying text. Any reference to the Illinois case law must therefore be checked closely to see if the underlying statutory provisions in both states are the same.

Also, of course, little attention should be paid to Illinois cases decided under the unitary property scheme that prevailed before paragraph 503(c) was enacted. The pre-503(c) cases are no longer consistent with Virginia law because Virginia has now rejected unitary property. VA. CODE ANN. § 20-107.3(A).

188. VA. CODE ANN. § 20-107.3(A)(1) (appreciation is marital property "only to the extent of the increases in value attributable to such [marital] contributions").

189. See L. GOLDEN, *supra* note 11, § 5.06A.

tions. The General Assembly intended that all marital contributions result in a marital interest proportional to the amount of resulting appreciation.

At the same time, however, the General Assembly realized that active appreciation questions are difficult to resolve. Answering questions involving appreciation often requires extensive expert testimony, extensive research by the parties, and extensive thought on the part of the trial judge.<sup>190</sup> This procedure is not cost-effective in every case, and it should be applied only when its benefits outweigh its burdens. Accordingly, the Illinois courts have recognized that "the requirement that no reimbursement is to be made unless a spouse's personal efforts are significant and result in substantial appreciation is designed to avoid *de minimus* claims."<sup>191</sup> For example, if the parties would have to pay \$5,000 in system costs<sup>192</sup> to classify only \$1,000 worth of personal effort which caused only \$2,000 worth of appreciation, the benefit is obviously not worth the cost.

The purpose of requiring significant efforts and substantial appreciation, therefore, is to ensure that the benefits of classifying appreciation are greater than the inherent cost of the classification process.<sup>193</sup> Given this purpose, the definition of "significant" and "substantial" should be relative rather than absolute. The court should balance the amount of personal effort and appreciation involved against the cost to the parties

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190. See, e.g., Levy, *An Introduction to Divorce-Property Issues*, 23 FAM. L.Q. 147, 154 (1989) (noting that active appreciation cases pose "daunting administrative problems").

191. *In re Morse*, 143 Ill. App. 3d 849, 854, 493 N.E.2d 1088, 1091 (1986).

192. Computing the system costs of classifying appreciation in separate property could easily consume an article in itself. The tangible expenses are obvious, including attorney's fees, expert's fees, and court costs. In addition, there are intangible costs. For instance, the trial judge must spend extra time and effort hearing and deciding the appreciation question. The appellate courts must likewise spend time and effort hearing the question, especially since active appreciation questions frequently generate complicated appeals. These judicial resources could arguably be better employed in other areas of the law.

193. The validity of this purpose lies largely outside the scope of this article. One could argue that the parties themselves will suffer most when the costs of litigating active appreciation outweigh the benefits, and that no statutory restriction is needed in order to prevent waste of judicial resources. Other states have certainly not been plagued by litigation over small amounts of active appreciation, and it seems unlikely that this will be a problem in Virginia under the new amendments. In addition, if there is a minimum efforts requirement in the statute, there is a risk that it would be incorrectly interpreted to establish an objective minimum unrelated to the costs of litigation. Such a minimum would penalize spouses making small marital contributions, who are probably disproportionately women.

Still, the decision to place a minimum effort requirement in the statute is not unreasonable. One of the most troublesome features of unitary property was the creation of large marital interests from small marital contributions. See notes 55-56 and accompanying text. The drafters were understandably sensitive to this problem, and added a minimum effort requirement to make certain it would not recur. Although the ability to award small marital interests made the restriction technically unnecessary to accomplish the legislative purpose, the restriction nevertheless provides extra certainty that the size of the marital interest will remain proportional to the marital contributions. As long as the minimum effort requirement is not used as an excuse to ignore small but still valuable marital contributions, it should not lead to unjust results.

and the public of litigating the question. If the expense of litigation exceeds the amount of personal effort involved, resolving the question may not be worthwhile.

This cost benefit approach is consistent with most of the Illinois case law. In *In re Tatham*,<sup>194</sup> the husband spent most of the marriage managing the wife's 1006-acre nonmarital farm. Among other things, he grew crops, raised cattle, and built a riding stable and arena. Although he had once received \$800 per month salary for his efforts, that salary stopped shortly after the parties were married.<sup>195</sup> The value of the husband's services obviously far exceeded the judicial cost of deciding the case, and the court had little trouble finding the husband's personal efforts to be significant.<sup>196</sup>

A contrary result was reached in *In re Morse*,<sup>197</sup> in which the husband owned a nonmarital insurance agency. The wife spent a few hours per day working for the agency, doing clerical work and serving as office manager. Except for selling two insurance policies, she did not make any direct contributions to the business.<sup>198</sup> Although the wife's services certainly had some value, the judicial cost of measuring the active appreciation likely would have exceeded the amount of appreciation involved. Accordingly, the court found that wife's effort was not significant, and that the appreciation was not substantial.

Illinois has yet to consider whether or not homemaker services can create active appreciation. The law in other states is split on this question.<sup>199</sup> Some states hold that appreciation caused by homemaker services is marital property,<sup>200</sup> while other states find such appreciation to be separate property.<sup>201</sup>

194. 173 Ill. App. 3d 1072, 527 N.E.2d 1351 (1988).

195. *In re Jatham*, 173 Ill. App. 3d 1072, 1081-83, 527 N.E.2d 1351, 1355-56 (1988).

196. *Id.* For further discussion of other issues raised in *Tatham*, see *infra* notes 210-216 and accompanying text.

197. 143 Ill. App. 3d 849, 493 N.E.2d 1088 (1986).

198. *In re Morse*, 143 Ill. App. 3d 849, 853, 493 N.E.2d 1088, 1091 (1986).

199. See generally L. GOLDEN, *supra* note 11, § 5.39; Turner, *supra* note 1, at 844.

200. See *Price v. Price*, 69 N.Y.2d 8, 503 N.E.2d 684, 511 N.Y.S.2d 219 (1986); *Goderwis v. Goderwis*, 780 S.W.2d 39 (Ky. 1989); *Cassiday v. Cassiday*, 68 Haw. 383, 716 P.2d 1133 (1986); *Weiss v. Weiss*, 226 N.J. Super. 281, 543 A.2d 1062 (App. Div. 1988); *Griffith v. Griffith*, 185 N.J. Super. 382, 448 A.2d 1035 (Ch. Div. 1982); *Beightol v. Beightol*, 90 N.C. App. 58, 367 S.E.2d 347 (1988).

201. See *In re Herr*, 705 S.W.2d 919 (Mo. Ct. App. 1986); *Applegate v. Applegate*, 219 Neb. 532, 365 N.W.2d 394 (1985); *Haldemann v. Haldemann*, 145 Wis. 2d 296, 426 N.W.2d 107 (Ct. App. 1988) (*dicta*).

These cases are particularly offensive because they refer to homemaker services as usual spousal duties not worthy of being considered in equitable distribution. The courts have been unclear as to the source of this spousal duty. No provision in the law of any state currently requires either spouse to perform homemaker services. At the most, because both spouses live in a joint home, each may have a duty to perform half of the homemaker services, but a full-time homemaker still contributes far more to a marriage than her usual spousal duty. Indeed, courts recognize the unique value of homemaker services at the division stage, by awarding homemaker spouses 50% or more of the marital assets. See *supra* note 28. There is no reason

The question is much less important in Virginia than in other states. Homemaker services can cause appreciation in two ways: directly or indirectly. Direct causation occurs when the appreciation is caused by homemaker services performed on the appreciated property itself.<sup>202</sup> Because homemaker services clearly fall within Virginia's broad definition of "personal effort,"<sup>203</sup> appreciation directly caused by homemaker services should always be marital property.

Indirect causation occurs when one spouse performs more than her share of homemaker services on assets other than appreciated separate property.<sup>204</sup> By taking on these extra duties, the homemaker frees the owning spouse to spend additional time and effort managing separate property. Indirect causation is an important issue in states where only the nonowning spouse's efforts can create active appreciation.<sup>205</sup> In Virginia, however, the efforts of either spouse can create active appreciation.<sup>206</sup> Thus, when the efforts of the owning spouse cause separate property to appreciate, the owning spouse's efforts alone are sufficient to make the appreciation marital, regardless of whether any indirect homemaker services are involved. Virginia's broad definition of "personal effort" allows us to sidestep the indirect homemaker services controversy.<sup>207</sup>

There is obviously substantial middle ground between the full-time farm work in *Tatham* and the occasional clerical work in *Morse*. In resolving questions within this gray area, the courts should lean toward finding that the significant efforts and substantial appreciation requirements were met. There is no unfairness to the parties in defining these terms liberally, because small marital contributions still yield only a small marital interest.<sup>208</sup> Virginia's unitary property background may lead to a

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why homemaker services should not be recognized equally when the services have created active appreciation. After reading the above cases, one is left with the unfortunate impression that the predominantly male appellate judiciary is discriminating against predominantly female homemaker spouses. See generally L. GOLDEN, *supra* note 11, § 5.39.

202. See, e.g., *Beightol v. Beightol*, 90 N.C. App. 58, 367 S.E.2d 347 (1988) (husband's rental property increased in value because wife provided free housekeeping services).

203. VA. CODE ANN. § 20-107.3(A)(3).

204. See *Price v. Price*, 69 N.Y.2d 8, 503 N.E.2d 684, 511 N.Y.S.2d 219 (1986).

205. In New York, for instance, appreciation in separate property is marital property only if it is caused by the efforts of the *nonowning* spouse. N.Y. DOM. REL. LAW § 236B(1)(d)(3) (1986); *Price v. Price*, 69 N.Y.2d 8, 503 N.E.2d 684, 511 N.Y.S.2d 219 (1986). Appreciation caused by the efforts of the owning spouse during the marriage is clearly a product of the marital partnership, and it should be marital property. The only way for New York courts to reach this desirable result is through reliance upon indirect homemaker services.

206. VA. CODE ANN. § 20-107.3(A)(3)(e).

207. See VA. CODE ANN. § 20-107.3(A)(3) (appreciation due to owner's personal effort is marital property).

208. *Id.* It could be argued that trial courts will be unwilling to find small amounts of active appreciation, just as courts were apparently unwilling to award highly unequal divisions in transmutation cases under unitary property. See *supra* notes 55-56 and accompanying text. If this proves to be true, there might be some basis for an objective minimum of personal effort needed to create a marital interest. It is doubtful that judges will be reluctant to award



fear that the marital interest will be disproportionate, but this is unlikely to happen under the new amendments. In fact, the only harm caused by classifying as significant small marital contributions is the cost to the judicial system of spending time and effort resolving *de minimis* claims. Because Virginia has already expressed its willingness to accept some difficulty in administration in order to reach a fair result,<sup>209</sup> the cost of resolving active appreciation claims should not be an overwhelming concern. Given any chance that the benefit to the parties might outweigh the cost to the system, therefore, the court should hold that limitations upon personal efforts are met.

## 2. Increase in Value

The statutory phrase "increase in value of separate property during the marriage"<sup>210</sup> seems clear enough upon its face. A court determines the value of the property on the date of valuation and then subtracts the value on the date of marriage. The difference is the increase in value, which is marital property if it was caused by marital contributions.

Beneath this placid surface, however, lies a difficult question: the distinction between improvement and maintenance. If \$10,000 in marital funds are used to make improvements on separate property, the increased value is clearly marital.<sup>211</sup> But what if the same \$10,000 is used for

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small amounts of active appreciation. If anything, judges in other states have tended to underestimate the amount of active appreciation. *See, e.g., Sanders v. Sanders*, 547 So. 2d 1014 (Fla. Dist. Ct. App. 1989) (remanding case for second time due to trial judge's refusal to recognize wife's interest in active appreciation of husband's farm). Unitary property is not a good analogy, for under that doctrine, protection of separate property depended upon the trial judge taking an affirmative act (an unequal division). Under active appreciation, by contrast, the trial judge must take an affirmative act (finding active appreciation) to protect marital property. If judicial inertia has any effect at all, therefore, it will help protect the separate interest. There is no reason to suspect that judges will reward small marital contributions with disproportionately large marital interests.

209. *See supra* note 39 and accompanying text.

210. VA. CODE ANN. § 20-107.3(A)(1).

211. This example assumes that the improvements are sufficiently general that they cannot be valued independently. If a court can determine the value of the improvements by themselves, it might treat the improvements as a new asset acquired by marital funds. *See Diehl, supra* note 85, at I-107 to I-108 (stating if marital funds used to add new room to separate property home, and new room is capable of being valued independently, room should be treated as distinct asset acquired with 100% marital funds); *cf. Thomas v. Thomas*, 259 Ga. 73, 78, 377 S.E.2d 666, 670 (1989) (noting that under source of funds rule, marital portion and separate portion of asset function much like distinct pieces of property). If improvements have no independent value, however, courts would treat the improvements as an increase in value of the improved property. Because the increase was caused by marital funds, the increase would constitute marital property. *See* VA. CODE ANN. § 20-107.3(A)(1).

There is no difference between these two methods if the property has not appreciated. \$10,000 in active appreciation is functionally the same as a new marital asset worth \$10,000. The difference is significant, however, if the property has appreciated. In that case, if the improvements are separable, the court will measure the appreciation in the improvements

maintenance? The statute could be read to require that increases in value be measured from the value on the date of marriage. There is some logic to this approach, because all property requires maintenance. If maintenance creates a marital interest, therefore, all separate property will slowly become marital.<sup>212</sup> On the other hand, the statute could be read to require that increases in value be measured from what the value would have been if no marital contributions had been made. This approach is also logical, because ignoring maintenance can be unfair to the marital estate. In our example, if there is no marital interest, the marital estate has lost \$10,000 without receiving any corresponding benefit.

The question came before an Illinois court in *In re Tatham*.<sup>213</sup> The husband in that case worked full time during the marriage on the wife's nonmarital farm, and received no salary for his efforts. There was an excellent argument that the increased value of the farm was marital property. The wife claimed, however, that the property did not appreciate, and that the marital estate should therefore receive no compensation at all for the husband's full-time services. The court seemed to disagree:

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separately from the appreciation in the rest of the property. It is possible, and probably even likely, that the percentage appreciation in the improvements will be different from the percentage appreciation in the rest of the property. On the other hand, if the improvements are inseparable, the court will have to apply the source of funds rule to the entire asset. The initial cost of the improvements would then be a marital contribution to the acquisition of the home, just like any marital contributions to the downpayment or the mortgage payments.

For example, assume that the parties buy a home using \$40,000 of the husband's separate funds, \$10,000 of the wife's separate funds, and \$10,000 of marital funds. Then, they spend \$15,000 of the wife's separate funds on improvements. If the improvements are separable, then the court will value the home and the improvements separately. Assuming the improvements are worth \$20,000 on the date of valuation, that amount will be the wife's separate property. Applying the source of funds rule to the remaining equity (the full equity less the \$20,000 improvements), two-thirds (40,000/60,000) would be the husband's separate property, and one-sixth (10,000/60,000) of the equity would be the wife's separate property and marital property respectively. If the improvements were not separable, the wife's separate contribution would be \$25,000 (\$10,000 original contribution plus \$15,000 spent on improvements). The husband's separate interest would then be 53.3% (40,000/75,000); the wife's separate interest would be one-third (25,000/75,000); and the marital interest would be 13.3% (10,000/75,000). The percentages would be multiplied by the entire equity.

Both of these results are consistent with the source of funds rule. The normal source of funds formula presumes that all parts of an asset appreciate in the same amount. Thus, if an asset as a whole increases in value by 30%, then the marital and separate interests individually also appreciate by 30%. This is only a presumption, however, and should be rebuttable if there is contrary evidence. Where separable improvements have appreciation in a different percentage from the rest of the asset, there is evidence that the general presumption of uniform appreciation is incorrect. The improvements should therefore not be classified under the normal source of funds formula.

212. Several Illinois cases reached this result under unitary property. These cases treated the matter as a question of causation, however, and not as a question of what constitutes an increase in value. For this reason, these cases are discussed fully at note 269 *infra* and accompanying text.

213. 173 Ill. App. 3d 1072, 527 N.E.2d 1351 (1988).

[T]he fact that respondent continued the day-to-day operation of the farm and did not permit the farm to deteriorate was another factor that the circuit court may have considered. Whenever strenuous efforts are made to maintain property values against overwhelming external factors such that it appears that the efforts were for naught, and especially in this time of ever increasing problems besieging the agriculture industry, it cannot be said that the property was not substantially appreciated even though the application of numerical values may appear to belie those efforts.<sup>214</sup>

This language suggests that an "increase in value" may result when "strenuous efforts" offset "overwhelming external factors" that otherwise would have caused substantial depreciation.<sup>215</sup> After making this suggestion, however, the court ultimately decided that the value of the property had increased. The above language, therefore, was not the basis for the court's decision.

Even so, *Tatham* suggests that marital contributions for maintenance might sometimes give the marital estate an interest in the underlying property. Such an interest is unlikely when the amount spent for maintenance is small. The balance of factors is different, however, when the marital contributions are substantial. In *Tatham*, for instance, if the property had not appreciated and the marital estate had been awarded no interest, the marital estate would receive no consideration at all for the husband's services during the marriage. In effect, he would have been working for free. Such a substantial loss of marital property would have been seriously unjust. Where a very substantial amount of marital property or personal effort is used to maintain separate property, courts should consider awarding a marital interest.<sup>216</sup>

### 3. Causation

The heart of active appreciation law is the last part of the test. The court will reach this prong of the test only if the court has already found that marital contributions were made and that the property increased in value. When both of these requirements are met, the court must then

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214. *In re Jatham*, 173 Ill. App. 3d at 1082-83, 527 N.E.2d at 1357 (1988).

215. *Id.*

216. See also *Van Newkirk v. Van Newkirk*, 212 Neb. 730, 325 N.W.2d 832 (1982) (marital interest exists if nonowning spouse "has significantly cared for the [separate] property during the marriage").

The entire question of contributions to maintenance also arises in the context of determining causation. See *infra* notes 260-64 and accompanying text. Indeed, since the question involves weighing of various policy interests, it is probably better considered as a causation problem. Still, the statute provides on its face that there must be an "increase in value" before causation is relevant. VA. CODE ANN. § 20-107.3(A)(1). Thus, if increases in value must in all cases be measured from the value on the date of marriage, rather than the value if no marital contributions had been made, the causation question never arises.

determine the extent to which the marital contributions caused the increase in value.

The extent to which marital contributions cause increase in the value of property is perhaps one of the most discussed issues in property division law. Many different commentators have addressed the question,<sup>217</sup> usually in relation to a series of causation tests developed in community property states in the early part of the twentieth century.<sup>218</sup> The drafters of the Virginia statute were aware of those tests in at least a general manner.<sup>219</sup> None of the community property tests is truly consistent with modern notions of the marital partnership,<sup>220</sup> however, and most equitable distribution states have adopted a more flexible approach.<sup>221</sup> Some decisions have taken this approach too far by treating all issues of causation as pure questions of fact.<sup>222</sup> Virginia should adopt the flexible equitable distribution approach, but it should recognize the legal as well as factual elements of causation.

#### a. Community Property

Community property states have generally refused to classify appreciation in separate property as marital or community property.<sup>223</sup> Never-

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217. See, e.g., L. GOLDEN, *supra* note 11, § 5.39; King, *The Challenge of Apportionment*, 37 WASH. L. REV. 483 (1962); Krauskopf, *supra* note 156; Reynolds, *supra* note 13.

218. See *infra* notes 215-30 and accompanying text.

219. See, e.g., Diehl, *supra* note 85, at I-8 to I-9 (briefly discussing reasonable compensation method and reasonable rate of return method, and suggesting that choice of method be made on case-by-case basis).

220. See *infra* notes 232-38 and accompanying text.

221. See *infra* notes 239-41 and accompanying text.

222. See *infra* notes 242-43 and accompanying text.

223. For a small selection of the early cases, see *Lombardi v. Lombardi*, 44 Nev. 314, 195 P. 93 (1921); *In re Cudworth's Estate*, 133 Cal. 462, 65 P. 1041 (1901); *In re Higgins*, 65 Cal. 407, 4 P. 389 (1884). The Texas Supreme Court reaffirmed this rule as recently as 1984. *Jensen v. Jensen*, 665 S.W.2d 107 (Tex. 1984). For an exhaustive discussion of the evolution of community property law on appreciation in separate property, see Reynolds, *supra* note 13, at 259-83.

In view of recent developments in equitable distribution states, classification of active appreciation can fairly be called the historical blind spot of community property. The problem has arisen largely because community property states view the community and separate interests as absolutely legally protected estates in property. Once property has been assigned to one estate, reassignment to another would constitute illegal seizure of private property. See e.g., *Jensen*, 665 S.W.2d at 109. This view is inconsistent with the marital partnership theory. If the parties' property is truly to be divided in proportion to their contributions to the marriage, the law must recognize that each party contributes at different times and in different ways. Since the balance of contributions to the marriage is constantly changing, the parties' interests in property do not remain constant. Equitable distribution states recognize this, and treat the marital interest as a flexible equitable lien which rises and falls throughout the marriage in both absolute and percentage terms.

The tradition of treating community and separate interests as absolute estates in property is strong, and change will probably not occur overnight. Nevertheless, community property law would reach better results if it began treating the parties' interest less like an estate in

theless, community property states have recognized for some time that a community interest should exist when community funds or efforts are used to improve separate property.<sup>224</sup> Community property states reconciled these competing policies by giving the community estate not an actual interest in separate property, but an equitable right of reimbursement.<sup>225</sup> The causation question first arose when courts tried to determine how much reimbursement should be granted.

A number of early reimbursement methods have little relevance to equitable distribution. Initially, many courts limited the measure of reimbursement to the value of the community funds or labor involved.<sup>226</sup> This method denied the community estate any return on its investment, and it is not presently followed in any state.<sup>227</sup>

Most community property courts today recognize that the amount of reimbursement should be the increase in value caused by community funds or efforts.<sup>228</sup> Thus, the causation question in community property states is the same as in equitable distribution states, even though community property law generally does not classify the appreciation as community property. For a time, many courts awarded either complete reimbursement or no reimbursement at all, depending upon whether the predominant cause of the appreciation was community or separate contributions. This method posed many of the same problems as a unitary property method, and it gradually fell out of use.<sup>229</sup>

The first serious attempts to answer the causation problem were made in the state of California. In the early twentieth century, the California cases identified two different competing approaches. Under the "reasonable rate of return method," all appreciation up to an objectively reasonable rate of return on the separate interest was passive, while all remaining appreciation was active.<sup>230</sup> Under the "reasonable compensation method," by contrast, the community estate was entitled to objectively reasonable compensation for the community contributions to the property.<sup>231</sup> In

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property and more like a lien. For example, Wisconsin adopted a community property law in 1985, but it continues to apply its equitable distribution statute when the marriage ends in divorce. See *Kuhlman v. Kuhlman*, 146 Wis. 2d 588, 432 N.W.2d 295 (Ct. App. 1988) (community property law applies only during the marriage, and not upon divorce); *Haack v. Haack*, 149 Wis. 2d 243, 440 N.W.2d 794 (1989) (rejecting constitutional challenge to *Kuhlman*). The result is a workable mixture of legal protection during the marriage and flexible distribution upon divorce. Other community property states would do well to consider Wisconsin's example.

224. See generally Reynolds, *supra* note 13, at 264-65, 276-77.

225. See *id.* at 276-77.

226. See Krauskopf, *supra* note 156, at 1015.

227. See Reynolds, *supra* note 13, at 275-76.

228. See Krauskopf, *supra* note 156, at 1018.

229. See *id.* at 1015-18.

230. See generally Reynolds, *supra* note 13, at 277-78; see also *Pereira v. Pereira*, 156 Cal. 1, 103 P. 488 (1909).

231. See generally Reynolds, *supra* note 13, at 278-82; see also *Van Camp v. Van Camp*, 53 Cal. App. 17, 199 P. 885 (1921).

computing reasonable compensation, however, the court had to include the owning spouse's salary as a benefit already received by the marital estate. The amount of active appreciation therefore equaled the reasonable value of the community contributions, less the owning spouse's salary.<sup>232</sup> All further appreciation was active.

An example may help illustrate both methods. Assume that the husband's separate property increased in value during a one-year marriage from \$100,000 to \$200,000. Assume further that \$10,000 worth of marital effort was used to improve the property, that the owner received \$5,000 in salary, and that the prevailing risk-free interest rate is 10 percent. Under the reasonable rate of return method, the separate estate would receive its base contribution (\$100,000) plus 10 percent interest, for a total of \$110,000. The community estate would receive the remaining \$90,000. Under the reasonable compensation method, the community estate would be entitled to the reasonable value of its contributions (\$10,000) less the salary already received (\$5,000). The remaining appreciation would go to the community estate. The community interest would therefore be \$5,000, and the separate interest \$195,000. As the example demonstrates, the two California methods can yield varying results.

Both California methods suffer from serious flaws. The reasonable compensation method is based upon the implied assumption that services with a reasonable value of \$10,000 will cause \$10,000 of appreciation.<sup>233</sup> If this assumption were true, then a business that paid fair salaries would never grow in value.<sup>234</sup> For every \$10,000 the business appreciated, the business would pay out exactly the same amount in salary. Common experience shows, however, that businesses pay average salaries often increase in value. (Indeed, this is almost the definition of a successful business.) The reasonable compensation method fails to recognize that services often contribute more to a business than their fair economic value. The reasonable compensation method can therefore seriously underestimate the amount of appreciation actually caused by marital contributions.<sup>235</sup>

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232. See Reynolds, *supra* note 13, at 280-81.

233. This assumption views the reasonable compensation method in its best light. Other commentators have argued that the reasonable compensation method awards the community only some arbitrary objective "reasonable" compensation for its contributions, rather than allowing the community to share in the gain or loss suffered by the property as a whole. Viewed in this way, the reasonable compensation method is clearly inconsistent with the basic source of funds principle that marital contributions are investments and not loans. See Reynolds, *supra* note 13, at 281.

234. Of course, the business could passively appreciate through external factors, such as increases in the value of its real property. A more proper conclusion would therefore be that if the assumption made by the reasonable compensation method is correct, then no business will ever rise or fall in value for any reason other than blind luck. This conclusion contradicts common experience just as much as the somewhat simplified conclusion made in the text.

235. See Reynolds, *supra* note 13, at 281 (criticizing reasonable compensation method and stating "When the courts 'compensate' the community instead of allowing it to share in the increase in value, the courts ignore the community's right to share the fruits of marital labor"); Krauskopf, *supra* note 156, at 1033 (stating that reasonable compensation method is unwarranted because it limits marital share to less than actual contribution).

The reasonable rate of return method suffers from too much reliance upon objective financial data. For instance, if an objective reasonable interest rate is 10%, then 10% of the appreciation will always be passive. This inflexible rule can sometimes be quite harsh. For instance, if 90% of the contributions are marital but the business appreciated only 11%, then the community's 90% contributions give it only 9.1% (1/11) of the overall appreciation. The fundamental problem in this example is that the objective reasonable interest rate is unreasonable for the specific separate asset being classified.<sup>236</sup>

The reasonable rate of return method works much better if the court uses not an objective rate, but a subjective rate based upon the experience of other similar types of separate property. For instance, a court classifying a separate property widget company would look to the reasonable rate of growth for the average company in the widget industry.<sup>237</sup> Looking to reasonable industry rates of growth does not completely eliminate the problem with objective reasonable interest rates discussed in the last paragraph, but such an approach does tailor the interest rate to the specific asset involved. As long as a proper rate of return is chosen, therefore, the reasonable rate of return method is the least objectionable approach.<sup>238</sup>

#### b. Equitable Distribution

Most equitable distribution states have ignored the community property experience. In fact, the author is unaware of a single recent equitable distribution case that has employed either of the two California methods by name. Instead, courts in equitable distribution states have taken a fresh look at the problem of causation. The equitable distribution decisions have not identified any single method of measuring causation. Instead, generally courts have treated the matter of causation as a question of fact that cannot be resolved by a simple formula.<sup>239</sup> The choice of method is left entirely to the trial judge, whose decision will be reversed only for an abuse of discretion.<sup>240</sup>

Judicial willingness to treat causation as a question of fact is in one sense a major step forward. Both community property methods can reach

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236. See Krauskopf, *supra* note 156, at 1029.

237. See *id.* at 1015-16, 1029 (discussing choosing rate of return under community property law).

238. Significantly, the only recent writer to propose an allocation method for use in equitable distribution states leaned toward the reasonable rate of return method. See *id.* at 1035. Krauskopf's marital effort method provides that a reasonable rate of return on the specific separate asset involved should be separate property, if the separate property owner proves that that economic conditions enhanced the value of the property. *Id.*

239. See *Macaluso v. Macaluso*, 523 So. 2d 615 (Fla. Dist. Ct. App. 1988); *cf. McCann v. McCann*, 142 Misc. 2d 1083, 1085, 539 N.Y.S.2d 281, 283 (1989) (lamenting lack of expert testimony on question of causation, and finding insufficient evidence to determine cause of appreciation). See generally L. GOLDEN, *supra* note 11, § 5.39.

240. See *Lawing v. Lawing*, 81 N.C. App. 159, 344 S.E.2d 100 (1986).

absurd results through their insistence upon using objectively average compensation and interest rates to judge specific fact situations.<sup>241</sup> In real life, however, no asset will ever be exactly average. When the asset involved fails to meet the court-determined averages, any formula-based method breaks down. By treating causation as a question of fact, the equitable distribution cases achieve greater flexibility and fairness.

In another sense, however, there are serious risks to treating causation as a pure question of fact. All too often, appellate courts use the factual standard as an excuse to avoid answering difficult questions of law. In reviewing the active appreciation decisions, one is struck by the almost complete lack of guidance the trial courts have received on the causation question.<sup>242</sup> As Virginia learned under unitary property, a lack of concrete standards increases litigation costs, discourages settlements, and frustrates the bench and bar.<sup>243</sup>

There is, of course, a limit to how much guidance courts can give in determining the cause of appreciation. The inquiry is fact-specific, and no two cases will ever be the same. Causation is not so fact-specific, however, that guidance is impossible. It is possible to strike a better balance between the need for flexibility and the need for objective standards. This article will suggest one way in which appellate courts might put more substance into the law of causation.

### c. Causes in Fact and Law

In looking for objective standards on the law of causation, one is immediately drawn to the law of torts. Causation has been a crucial question in tort law for generations, and courts have devised a workable method for answering questions involving causation.<sup>244</sup> In tort law, causation remains mostly a question of fact,<sup>245</sup> but there are sufficient rules of law to provide reasonable guidance on how the inquiry should be structured.

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241. See *supra* notes 220-24 and accompanying text.

242. For instance, in *Lawing v. Lawing*, the court remanded the case with these instructions:

The court should make findings as to the value of the shares at time of inheritance and as of the date of valuation. It then should determine what proportion of that increase was due to funds, talent or labor that were contributed by the marital community . . . , as opposed to passive increases due to interest and rising land values of land owned at inheritance, and the efforts of [third parties]. We recognize that we cannot require mathematical precision in making this determination. . . . Nevertheless, the trial court must make a reasoned valuation, identifying to the extent possible the factors it considered.

*Lawing v. Lawing*, 81 N.C. App. 159, 176, 344 S.E.2d 100, 112 (1986). It is hard to see how the above paragraph gave the trial judge any real guidance at all.

243. See *supra* notes 52-54 and accompanying text.

244. See generally W. PROSSER & W. KEETON, PROSSER AND KEETON ON TORTS chap. 7 (5th ed. 1984).

245. *Id.* § 41, at 264-65.



Causation in the law of torts is a two-pronged inquiry. First, the court must determine whether the defendant's conduct is a cause in fact of the plaintiff's injuries.<sup>246</sup> Causation in fact is "but for" causation: if the defendant had not been negligent, would the plaintiff have been injured?<sup>247</sup> The test requires the court to compare the actual state of affairs with the hypothetical state of affairs that would have resulted if the defendant had not been negligent.<sup>248</sup> If the plaintiff would not have been injured in this hypothetical fact situation, the defendant's actions are not the cause in fact of the plaintiff's injuries.<sup>249</sup>

Not every cause in fact, however, is a cause in law. Every law student has his own favorite case in which an improbable series of events caused an unlikely injury.<sup>250</sup> In these cases, even though the cause in fact test is met, the defendant is still not liable. In the language of the courts, his conduct is not the *proximate* cause of the plaintiff's injuries.<sup>251</sup>

Volumes have been written on the definition of proximate causation in the law of torts, and the rules are far too numerous to summarize here.<sup>252</sup> The important point is that proximate cause is a question of public policy rather than a question of observed fact.<sup>253</sup> The court is concerned not with metaphysical notions of cause and effect, but with the question of whether equity demands that the defendant should be responsible for the plaintiff's injuries.<sup>254</sup> This is by no means an easy test to predict or apply, but it is an honest and straightforward approach. The parties involved know that policy is the test, and they direct their arguments specifically in those terms. The resulting judicial opinions make clear policy choices, which then provide guidance for future cases. Because the law of proximate cause recognizes policy issues and addresses them directly, the law of proximate cause has struck a very appropriate balance between flexibility and certainty.

A similar approach could be imported into the law of equitable distribution. As in the law of torts, causation in active appreciation cases should consist of two parts: causes in fact and causes in law. To determine

246. *Id.* § 41, at 263-65. See *Wells v. Whitaker*, 207 Va. 616, 151 S.E.2d 422 (1966).

247. W. PROSSER & W. KEETON, *supra* note 244, § 41, at 266-67. See *Wells*, 207 Va. at 622, 151 S.E.2d at 428.

248. W. PROSSER & W. KEETON, *supra* note 244, § 41, at 265.

249. *Id.*

250. See, e.g., *Palsgraf v. Long Island R.R.*, 248 N.Y. 339, 162 N.E. 99 (1928) (finding defendant railroad company not liable when railroad's employee clumsily assisted passenger in boarding train, causing her to drop package of fireworks; package exploded, causing several scales located some distance away to fall upon the plaintiff).

251. *Id.* See generally W. PROSSER & W. KEETON, *supra* note 244, § 43, at 284-90.

252. See W. PROSSER & W. KEETON, *supra* note 244, § 41, at 263 n.1 (giving brief selection of literature).

253. *Id.* § 42 at 272-75; see *Wells v. Whitaker*, 207 Va. 616, 622, 151 S.E.2d 422, 428 (1966) ("Proximate cause has been described as a shorthand descriptive phrase for the [policy] limits the law has placed upon an actor's responsibility for his conduct").

254. W. PROSSER & W. KEETON, *supra* note 244, § 41, at 272-75.

causation in fact, the court should determine what the value of the property would have been if there had been no marital contributions. The difference between this hypothetical value and the actual value of the property is the amount of appreciation caused in fact by the marital contributions.<sup>255</sup>

Because "but for" causation is a question of fact,<sup>256</sup> the result will depend greatly upon the circumstances of the case presented. Nevertheless, a list of relevant factors in determining the causation of increased property values can be distilled from the reported case law:

1. *Type of Asset.* Marital contributions affect the value of some types of assets more than others. For instance, real estate often appreciates passively, because no one person has any real control over fluctuating real estate prices.<sup>257</sup> Conversely, close corporations often appreciate actively, because their value depends greatly upon the owner's efforts.<sup>258</sup>

2. *Similar Assets.* If the asset in question has appreciated more than other assets in similar conditions, the extra appreciation may be due to marital skill and effort.<sup>259</sup> If the asset has appreciated less than other similar assets, there is likely to be little or no active appreciation.

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255. The statutory phrase "increase in value during the marriage" could refer only to the increase upwards from the value on the date of marriage. See *supra* notes 211-16 and accompanying text. If so, then the amount of appreciation caused in fact could not exceed the difference between the value on the date of marriage and the value on the date of valuation.

This limitation would not apply if "increase in value" can be measured from the value if no marital contributions had been made. Of course, as discussed below, the difference between value at the time of marriage and value if no marital contributions had been made—essentially, the increase in value caused by maintenance—will not be caused at law by marital contributions unless special circumstances are present. See *infra* notes 268-72 and accompanying text.

256. See W. PROSSER & W. KEETON, *supra* note 244, § 41, at 264 (stating cause in fact is question "upon which all the learning, literature and lore of the law are largely lost. It is a matter upon which lay opinion is quite as competent as that of the most experienced court").

257. See *Nardini v. Nardini*, 414 N.W.2d 184, 194 n.8 (Minn. 1987).

Some commentators have argued that the type of asset should not be a factor in determining causation. Their rationale is essentially that courts use the type of asset factor as a rationale for limiting the amount of active appreciation and thus reducing the nonowning spouse's share of the marital estate. See, e.g., Reynolds, *supra* note 13, at 288 (classification should not depend upon "the fortuity of the kind of separate property a spouse happens to own").

Of course, we should not use generalizations about the type of asset as a substitute for full analysis. Nevertheless, the law must recognize the differences between various types of property. For instance, a skilled operator can cause immense appreciation in the value of a close corporation, while real estate prices are generally beyond the control of any single landowner. As a matter of economic reality, therefore, appreciation in close corporations is frequently active, while appreciation in real estate is frequently passive. The law gains nothing by ignoring these obvious differences. Appreciation should not be deemed passive merely because real estate is involved, but the owner's lack of control over real estate prices should be a factor in most real estate appreciation cases.

258. See *Nardini*, 414 N.W.2d at 194 (noting that "a business, like a garden, must be tended if it is to flourish").

259. See *Haldemann v. Haldemann*, 145 Wis. 2d 296, 426 N.W.2d 107 (1988) (wife's farm increased in value while farm values were generally falling; appreciation held active).

3. *Third Parties.* If appreciation can be traced to the acts of third parties, it was obviously not caused by marital contributions.<sup>260</sup> Third parties include not only co-owners of the property involved, but also governments and other institutions with influence over the economy.<sup>261</sup>

4. *Control and Expertise.* If the owning spouse has complete control over the asset, it is more likely that the efforts of the owning spouse caused the appreciation.<sup>262</sup> A finding of causation is especially likely if the owner also has special expertise in the field.<sup>263</sup> If the owner had little or no control (as in, for instance, an owner of IBM stock), the owner's efforts were probably irrelevant.<sup>264</sup>

260. See *Lawing v. Lawing*, 81 N.C. App. 159, 344 S.E.2d 100 (1986) (appreciation caused by efforts of husband's partner held passive).

261. See *Hoffmann v. Hoffmann*, 676 S.W.2d 817 (Mo. 1984) (demand for corporation's products increased greatly after enactment of federal environmental control laws; appreciation held passive); *Myers v. Myers*, 70 Haw. 143, 764 P.2d 1237 (1988) (favorable change in dollar/yen ratio; appreciation held passive).

262. See *McLeod v. McLeod*, 74 N.C. App. 144, 327 S.E.2d 910 (majority shareholder in close corporation; appreciation held mostly active), *cert. denied*, 314 N.C. 331, 333 S.E.2d 488 (1985).

263. See *Lester v. Lester*, 547 So. 2d 1241, 1242 (Fla. Dist. Ct. App. 1989) (husband "was a recognized genius in his field and was firmly engaged in running his business"; appreciation held active). Of course, to the extent the owner made unusually skilled contributions, his or her contributions to the asset were greater than the nonowner's, and the argument for an unequal division becomes stronger. See *Teitler v. Teitler*, 156 A.D.2d 314, 549 N.Y.S.2d 13 (1989) (appreciation in art studio caused almost entirely by wife's skill as artist was active, but husband's interest in appreciation was only 25%).

264. See *Shahidi v. Shahidi*, 129 A.D.2d 627, 514 N.Y.S.2d 259 (1987) (appreciation in husband's IBM stock held passive).

It is important, however, that control be defined in a flexible manner. Even when the parties do not have control over the value of a particular asset, the parties still have control over whether or not their funds will be invested in that asset. Therefore, where the owning spouse used his own efforts and expertise to select unusually wise investments, the appreciation has been held active even though neither spouse had control over the investments' values. See *Nolan v. Nolan*, 107 A.D.2d 190, 486 N.Y.S.2d 415 (1985) (unemployed husband spent all his time and effort managing separate property securities portfolio; appreciation held active); *DeMarco v. DeMarco*, 143 A.D.2d 328, 532 N.Y.S.2d 293 (1988) (parties jointly invested husband's personal injuries award; appreciation held active); *Miceli v. Miceli*, 533 So. 2d 1171 (Fla. Dist. Ct. App. 1988) (same situation as *Nolan*; error to award wife none of the husband's property); *Fredel v. Fredel*, 531 So. 2d 981 (Fla. Dist. Ct. App. 1988) (appreciation in actively traded stock portfolio held active); *cf. McLeod v. McLeod*, 74 N.C. App. 144, 327 S.E.2d 910 (suggesting that business decision to redeem shares owned by another shareholder might create active appreciation), *cert. denied*, 314 N.C. 331, 333 S.E.2d 488 (1985). One commentator has suggested that the decision to retain an investment might be marital property. See Reynolds, *supra* note 13, at 323. No reported case has yet reached this result.

This entire issue might best be considered under the tort law-based theory of causation discussed below. See *supra* and *infra* notes 244-81 and accompanying text. As a factual matter, any investment decision can cause appreciation, regardless of whether it is a decision to buy, a decision to sell, or a decision to retain. This conclusion is particularly clear in Virginia, due to the broad statutory definition of personal effort. VA. CODE ANN. § 20-107.3(A)(3). It is less clear, however, whether investment decisions should be the cause in law of resulting appreciation. Most states have been willing to recognize increases caused by buying or selling,

5. *Marital Funds*. If marital funds are invested in the property, it is highly unlikely that the amount of appreciation caused by the funds would be less than the amount invested.<sup>265</sup>

After determining how much appreciation was caused in fact by marital contributions, a court should consider as a matter of policy whether the factual causes of the appreciation constitute causes at law. Because policy matters are questions of law, the trial judge's opinion on this point should not be given special deference.<sup>266</sup> Instead, the court should determine whether recognizing all of the appreciation is consistent with the marital partnership theory and the purposes of the statute.

Since no state currently follows a tort-law-based theory of causation, there is no case law expressly analyzing causation issues under a cause at law method. Nevertheless, there are a number of cases in which the court's decision on causation was based upon concerns of policy rather than concerns of fact.<sup>267</sup> In essence, these cases have implicitly applied cause at law analysis.

There are several common issues which tend to be resolved by a policy oriented type of analysis. The first of these is appreciation caused by maintenance. When marital funds are used to maintain separate property, the marital funds obviously cause the value of the property to increase. Had the marital funds not been used, the value of the separate property would be much less.<sup>268</sup> As a practical matter, however, almost all separate property requires some maintenance. Separate property would therefore gradually disappear if maintenance caused active appreciation.<sup>269</sup> Moreover,

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but no state has yet recognized appreciation caused by the decision to retain an investment. Such recognition would significantly reduce the amount of separate investment property, since many spouses owning investments make a deliberate decision to retain the property during marriage. Moreover, it would make active appreciation an issue in every case involving investments, reducing the cost-effectiveness of divorce litigation. Retention of investments is therefore similar in many ways to maintenance, which is not the cause in law of appreciation unless special circumstances are present. *See infra* note 268-71 and accompanying text. When the issue arises, there is a good chance that retention of an investment will be held not to be the cause in law of any resulting appreciation.

265. *See, e.g.,* McCann v. McCann, 142 Misc. 2d 1083, 1086, 539 N.Y.S.2d 281, 283 (1989) (where parties introduced no evidence on causation, "it would be inappropriate for this court to randomly select a percentage of appreciation attributable to the [nonowner's] direct or indirect contributions"; but because \$18,000 in marital funds had been used to improve the home, \$18,000 of appreciation was deemed marital).

266. *Cf. W. PROSSER & W. KEETON, supra* note 244, § 42, at 273 ("Unlike the fact of causation, with which it is often hopelessly confused, this is primarily a problem of law").

267. *See infra* notes 268-73 and accompanying text; *see also supra* note 256.

268. *Cf. supra* note 248 (test for causation in fact is whether value would be less if marital contributions had not been made). Where property is maintained with marital funds, its value would obviously be less if it had not been maintained at all. Contributions to maintenance are therefore the cause in fact of appreciation in the maintained property.

269. *See In re Olson*, 96 Ill. 2d 432, 451 N.E.2d 825 (1983) (holding that contributions to maintenance do not produce marital interest); *In re Frazier*, 125 Ill. App. 3d 473, 466 N.E.2d 290 (1984) (same). These Illinois cases are distinguishable because they were decided

almost every case would pose active appreciation questions, thus burdening the courts with difficult legal issues.<sup>270</sup> As a matter of policy, therefore, maintenance with marital funds usually does not cause active appreciation.<sup>271</sup> The maintenance is a cause in fact, but it is not a cause in law.<sup>272</sup>

A second situation arises when the owning spouse received a fair and reasonable salary. Some courts have applied reasoning similar to the reasonable compensation method and limited the amount of active appreciation to the fair value of the marital contributions.<sup>273</sup> Again, even where the owning spouse's salary is reasonable, there is no doubt that marital contributions can be the cause in fact of appreciation in the property. If the marital estate is limited to a reasonable salary, therefore, it is because the marital contributions were not a cause in law of any excess appreciation.<sup>274</sup>

These two situations demonstrate how a tort law test of causation could improve equitable distribution law. Courts considering the mainte-

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under unitary property. If the court had found that maintenance with marital funds created even a small marital interest, the entire value of the property would have been marital. Under the new amendments to the Virginia statute, however, small marital contributions can be rewarded with a small marital interest. The Illinois cases are therefore not entirely consistent with current Virginia law. Still, the difference goes only to the degree of danger and not to its existence. If contributions to maintenance were the cause in law of increased value, no asset would ever be entirely separate property.

270. See *supra* note 186 and accompanying text (active appreciation questions require large expenditure of attorney time, judicial time, and other system costs).

271. See *In re Olson*, 96 Ill. 2d 432, 451 N.E.2d 825 (1983); *In re Frazier*, 125 Ill. App. 3d 473, 466 N.E.2d 190 (1984); *Haldemann v. Haldemann*, 145 Wis. 2d 296, 426 N.W.2d 107 (1988) (dicta).

272. Of course, this balancing of policy factors might hold true in all cases. If the marital contributions to maintenance are sufficiently large to overcome the objections discussed in the text, a marital interest might exist. The court strongly hinted that it would follow this rationale in *In re Tatham*, 173 Ill. App. 3d 1072, 527 N.E.2d 1351 (1988), but eventually decided that the property had appreciated. There was therefore no need to consider the maintenance question. See *supra* notes 208-16 and accompanying text (giving full discussion of *Tatham*).

273. Only one equitable distribution case has actually reached this holding. See *In re Morse*, 143 Ill. App. 3d 849, 493 N.E.2d 1088 (1986) (instructing trial court that no marital interest should be found upon remand if owner's salary was fair and reasonable).

Several other cases state the rule without formally adopting it as a holding. In *Hoffmann v. Hoffmann*, the court stated that active appreciation could not exist unless the owner's salary was not fair and reasonable. *Hoffman v. Hoffman*, 676 S.W.2d 817 (Mo. 1984). Ultimately, however, the *Hoffman* court held that the appreciation was caused by fortuitous enactment of federal legislation, and therefore not caused by marital contributions. Accordingly, the court's comments on the salary question were dicta. See also *Krauskopf*, *supra* note 156, at 1032 & n.176 (questioning whether *Hoffman* made use of reasonable compensation method mandatory or merely permissive); *Haldemann v. Haldemann*, 145 Wis. 2d 296, 426 N.W.2d 107 (1988) (approving of rule in dicta, but ultimately finding appreciation active).

274. The reasonable compensation approach is discussed here as an example of how courts are already implicitly using cause in law reasoning in active appreciation cases. This discussion should not be interpreted as approving of the reasonable compensation approach. The reasonable compensation approach is inconsistent with the marital partnership theory, and no equitable distribution state has expressly accepted it. See *supra* notes 225-27 and accompanying text (discussing flaws of reasonable compensation approach).

nance and fair salary situations often have failed to distinguish causes in fact from causes in law.<sup>275</sup> This treatment is confusing because, by any fact-based standard of causation, contributions to maintenance and contributions paid for with a fair salary obviously can cause property to appreciate. From a pure cause in fact viewpoint, therefore, these cases confuse the reader by reaching an obviously incorrect result. The real basis for the decisions would have been much more apparent if the courts had expressly recognized that for policy reasons, they were limiting the number of causes in fact which the law will recognize. Cause in law analysis would therefore make causation decisions significantly easier to understand.

Focusing upon the policy interests also allows us to reach better decisions. For instance, under a cause in law approach, there is no absolute rule that contributions to maintenance can never cause an increase in value. Instead, we have merely observed that in most cases, the policy goals of protecting separate property and avoiding litigation would be unduly hindered if maintenance were sufficient to create active appreciation.<sup>276</sup> That hindrance may not be present, however, in all cases. If the marital contributions are sufficiently large, the balance of policy factors may be different. This possibility was at least mentioned in *In re Tatham*,<sup>277</sup> in which the husband worked full time for no salary maintaining the wife's nonmarital farm. By implicitly using a cause in law approach, the *Tatham* court was better able to recognize a fact situation meriting departure from the general rule.

Similarly, when we focus upon policy concerns, we can better determine whether decisions in other states are consistent with Virginia law. For instance, the policy factors supporting the reasonable compensation approach are largely unique to community property states. The method arose in California, where the courts must divide the community assets equally between the parties.<sup>278</sup> Thus, if the court feels that the wife should not receive half of the property, it can achieve this goal only by limiting the amount of community property. In the leading reasonable compensation case, the court was motivated primarily by a desire not to give the wife much property because the marriage had been a marriage of convenience.<sup>279</sup> Virginia law differs from California law on a crucial issue, however, because the Virginia courts need not divide the property equally.<sup>280</sup>

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275. Most of the decisions state simply that the marital contributions involved did not create active appreciation, without explaining their reasoning in any great detail. See, e.g., *In re Morse*, 143 Ill. App. 3d 849, 493 N.E.2d 1088 (1986) (adopting fair salary approach without discussing matter in detail or giving supporting reasons). The problem therefore goes deeper than mere failure to distinguish causes in fact from causes in law. Many courts have decided the question of causation without any express analysis at all.

276. See *supra* notes 268-71 and accompanying text.

277. *In re Tatham*, 173 Ill. App. 3d 1072, 527 N.E.2d 1351 (1988). See *supra* notes 199-202 and accompanying text (discussing *Tatham*).

278. See CAL. CIV. CODE § 4800 (Supp. 1990).

279. See Krauskopf, *supra* note 156, at 1016.

280. See *Papuchis v. Papuchis*, 2 Va. App. 130, 341 S.E.2d 829 (1986).

There is therefore no need to reduce the marital interest merely because the wife should receive less than half of the marital property. When we look at the policy factors, we find that reasons behind a reasonable compensation approach are much weaker in Virginia than in community property states.

Finally, a public policy analysis helps us identify additional policies not considered in some of the reported cases. One such policy involves the economic choices presented to the parties during the marriage. Equitable distribution law should encourage the parties to make these choices fairly, and should not reward a spouse who makes them self-interestedly. The owner of a close corporation, for example, has the power to choose how much salary he will pay himself. If the marital interest is limited to reasonable compensation for the owner's efforts, the owner will be encouraged to take only a reasonable salary, and accumulate the remainder of the corporation's earnings. In order to discourage owning spouses from making this unfair choice, several recent decisions have rejected the reasonable compensation approach.<sup>281</sup> By implicitly applying a policy-based cause in law approach, these courts have realized that traditional policies such as the reasonable compensation approach often encourage choices which are unfair to the dependent spouse. This important point has been missed by courts applying more formula-based approaches.

A tort-law-based theory of causation therefore offers important advantages to courts considering active appreciation issues. By focusing attention more upon the policy concerns and less upon philosophies of cause and effect, a tort-based approach encourages courts to identify clearly the real factors behind their decisions. Honest analysis does not guarantee easy decisions, but it does guarantee that the real questions will be confronted directly.

#### 4. Burden of Proof

The statute does not expressly state who bears the burden of proof when classifying appreciation in separate property. This question has arisen nationwide in only a few equitable distribution states, and there is no clear consensus. In the only decision to consider the question directly, a Florida court held that the burden is on the owner to prove that the appreciation was passive.<sup>282</sup> A larger number of other decisions, however, have classified appreciation as passive when there was no proof as to the cause of the appreciation.<sup>283</sup> Implicitly, therefore, these cases have placed

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281. See *McLeod v. McLeod*, 74 N.C. App. 144, 327 S.E.2d 910, *cert. denied*, 314 N.C. 331, 333 S.E.2d 488 (1985); *Wade v. Wade*, 72 N.C. App. 372, 325 S.E.2d 260, *cert. denied*, 313 N.C. 612, 330 S.E.2d 616 (1985); see also *Nardini v. Nardini*, 414 N.W.2d 184 (Minn. 1987).

282. *Massis v. Massis*, 551 So. 2d 587 (Fla. Dist. Ct. App. 1989).

283. See, e.g., *McNaughton v. McNaughton*, 74 Md. App. 490, 538 A.2d 1193 (1988); *Smith v. Smith*, 154 A.D.2d 365, 545 N.Y.S.2d 842 (1989); *McCann v. McCann*, 142 Misc. 2d 1083, 539 N.Y.S.2d 281 (Sup. Ct. 1989); *Popp v. Popp*, 146 Wis. 2d 778, 794, 432 N.W.2d 600, 605 n.3 (Ct. App. 1988).

the burden upon the nonowner to prove that the appreciation was active.

The Florida case seems more consistent with Virginia law. In Virginia, as a general rule, property is presumed to be marital unless proven to be separate.<sup>284</sup> The statute does not state expressly whether the presumption applies to appreciated separate property, so a presumption of active appreciation is certainly not required.<sup>285</sup> Still, the presumption on its face applies to all fact situations. Unless there are clear reasons for a different rule, appreciation in separate property should be presumed to be marital.

An examination of the relevant policy concerns does not yield a clear basis for placing upon the nonowner the burden of proving the causation of appreciation. Instead, the policy factors support placing the burden upon the owner in at least some situations. First, the experience of other states shows that appreciation is more often active than passive.<sup>286</sup> When courts have found appreciation to be passive, the rationale has almost always been that no marital contributions were made.<sup>287</sup> In other words, when parties have made marital contributions and the property has appreciated, the appreciation has generally been held to be active. Classification as active is therefore the most common result, at least when marital contributions were made.

Second, the owning spouse is more likely to have in his possession the necessary documents to determine the cause of appreciation. In states in which the burden is placed at least implicitly upon the nonowner, owning spouses have been very reluctant to release the necessary financial information.<sup>288</sup> Often, owning spouses have complied with discovery requests only after repeated court orders and threatened sanctions.<sup>289</sup> Equi-

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284. VA. CODE ANN. § 20-107.3(A)(2). Technically, the marital property presumption applies only to property acquired during the marriage. *Id.* Under a strict construction of this limitation, appreciation in inherited or gifted property could be presumed active, while appreciation in premarital property could be presumed passive. These differing presumptions would be absurd, however, because there is no relevant difference between the various types of separate property. Inheritances, gifts and property brought into the marriage are all equally outside the marital partnership unless improved with marital contributions. The same burden of proof should therefore apply in all active appreciation cases, regardless of the type of separate property involved.

285. At the very least, there is a substantial difference between presuming that property acquired during the marriage is marital property and presuming that appreciation in separate property is marital property. In the former instance, the court must classify the entire asset. In the latter instance, by contrast, the court is classifying only part of the asset (the appreciation), and the rest of the asset (the underlying value) is unquestionably marital. Arguably, because part of the asset has already been classified as separate, it is more likely that the rest of the asset will be separate. The case for presuming that unappreciated property is marital is therefore stronger than the case for presuming that appreciation in separate property is marital.

286. See Krauskopf, *supra* note 156, at 1034-35.

287. See L. GOLDEN, *supra* note 11, § 5.39 (Supp. 1990).

288. See *id.*

289. The seriousness of the problem is most evident from a review of the cases imposing sanctions upon owning spouses for failure to disclose information. See L. GOLDEN, *supra* note



table distribution is burdensome enough upon the courts without unnecessary discovery litigation. Placing the burden upon the owning spouse would put the burden on the party best equipped to meet it.

At the very least, therefore, the owning spouse should have the burden of proving causation. The relevant financial information will be in the owner's hands, and where marital contributions have been made, causation is by far the most common result.<sup>290</sup> Conversely, many cases have found that no marital contributions were made or that property did not appreciate. The burden of proving marital contributions and appreciation should remain upon the nonowning spouse.<sup>291</sup>

11, § 4.04 (Supp. 1990). The most common objection raised by the owning spouse has been that the interest of his business in the privacy of its own financial records outweighs the nonowning spouse's equitable distribution rights. Although this argument has been uniformly rejected, *see id.* § 4.06, owning spouses still persist in making the argument to increase the difficulty and expense of proving active appreciation. *See id.* §§ 4.04-4.06 (discussion of discovery in equitable distribution cases).

290. *See supra* notes 286-87 and accompanying text.

291. A presumption that separate property has appreciated would be unworkable, because appreciation is ordinarily only a portion of the total asset. In order to presume appreciation, we would have to presume that every asset appreciated by some specific percentage during the marriage. There is no statutory basis for arbitrarily choosing such a figure. Also, previous attempts to allocate appreciation using objective average rates of return have created more problems than they have solved. The burden of proving appreciation should be on the nonowning spouse.

In a previous publication, I suggested that the burden of proving no marital contributions should be upon the owning spouse. *See* L. GOLDEN, *supra* note 11, § 5.39 (Supp. 1990). The issue of which party should bear the burden of proving no marital contributions is a close one, but at least in the specific context of the Virginia statute, I am inclined to place the burden upon the nonowner. Very few reported cases find no causal connection between marital contributions and appreciation, but a much larger number of cases find that there were no marital contributions to begin with. *See generally* L. GOLDEN, *supra* note 11, § 5.39. Existence of marital contributions is therefore not the most common result. Placing the burden upon the nonowner would probably not result in significant injustice, because it would be fairly easy to prove that some marital contribution was made. Finally, as noted at *supra* note 192 and accompanying text, active appreciation issues are difficult and expensive to resolve. The presence of the "substantial" appreciation and "significant" personal effort requirements in the Virginia statute shows the legislature's awareness of this fact. VA. CODE ANN. § 20-107.3(A)(1). *See supra* notes 184-87 and accompanying text. Requiring affirmative proof of appreciation and marital contributions will help ensure that expensive active appreciation questions will not be litigated needlessly.

This result is not entirely inconsistent with Krauskopf who advocates an apparently unconditional presumption of active appreciation. *See* Krauskopf, *supra* note 156. Krauskopf's rationale is that "[t]he practical context of the apportionment issue is a marriage in which marital effort has been expended for the benefit of the family. . . . Assuming the goal of equitable distribution is to recognize the full marriage partnership concept, the marital estate should be favored." Krauskopf, *supra* note 156, at 1034-35. I agree that the marital estate should be favored when marital effort has been expended for the benefit of the family, but there are a substantial number of cases in which no such marital effort was expended on separate property. *See generally* L. GOLDEN, *supra* note 11, § 5.39. Certainly this is not the "practical context" of all of the reported cases. By refusing to presume marital contribution, we are essentially adopting Krauskopf's presumption, but requiring affirmative proof that its underlying condition is met.

## III. JOINTLY TITLED PROPERTY

The status of jointly titled property under the new amendments is unclear. Before 1990, the statute defined all jointly titled assets as marital property.<sup>292</sup> The new amendments, however, provide that all marital and separate contributions to property acquired during the marriage shall retain their identity if such contributions can be traced by a preponderance of the evidence.<sup>293</sup> Unfortunately, the new amendments did not expressly state whether or not the tracing provisions control the provision that all jointly titled assets are marital. The statute therefore contains two contradicting provisions, and the courts will have to reconcile the conflict.

The most likely answer is that jointly titled assets are still marital property. The joint title provision is a specific statute applying only to jointly titled property, while the tracing provision is a general statute applying to a broader range of property. Ordinarily, if two statutes conflict, the more specific one will control.<sup>294</sup> Also, if jointly titled assets can be separate property, then the joint title provision of the statute would have no effect.<sup>295</sup> Such a construction would violate the general rule that all provisions of a statute must have some effect.<sup>296</sup> The drafters did tell the legislature that the tracing provisions would control,<sup>297</sup> but legislative history is relevant only when the statute is ambiguous.<sup>298</sup> The question is close, but the statute may not be sufficiently ambiguous to permit evidence of legislative intent. Jointly titled assets will probably continue to be marital property under the new amendments.

The general rule in other equitable distribution states is that jointly titled property is presumed to be a gift to the marital estate.<sup>299</sup> The

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292. VA. CODE ANN. § 20-107.3(A)(2)(i).

293. VA. CODE ANN. § 20-107.3(A)(3)(d-e).

294. See *Commonwealth v. United Airlines, Inc.*, 219 Va. 374, 248 S.E.2d 124 (1978). The Virginia cases tend to speak in terms of general and specific words rather than general and specific statutory provisions, but the basic principle should apply equally in both contexts.

295. In other words, if the tracing provision controls, jointly titled property will be classified under the source of funds rule. This is exactly the same result which would occur if the joint title provision had been repealed. Because the legislature did not repeal the joint title provision, it must have intended that the provision have some effect upon the law of equitable distribution.

296. See, e.g., *Jones v. Conwell*, 227 Va. 176, 314 S.E.2d 61 (1984).

297. See Legislative Subcommittee Analysis, *supra* note 57, at 2 (example 2) (new amendments will allow court to trace funds in joint savings account); *id.* at 5 (example 6) (tracing funding in joint checking account). It may be significant that all of the joint title situations presented to the legislature involved joint bank accounts, and not jointly titled real property. This is further evidence that the legislature did not comprehensively consider the joint title problem. It would probably be a mistake, however, to apply different rules to jointly titled bank accounts and jointly titled real property. This distinction is present drawn only in North Carolina. See *Manes v. Harrison-Manes*, 79 N.C. App. 170, 338 S.E.2d 815 (1986). *Manes* has encountered substantial criticism. See, e.g., Sharp, *supra* note 128, at 227-28. Virginia should apply a single rule for classifying all jointly titled property.

298. See, e.g., *Brown v. Lukhard*, 229 Va. 316, 330 S.E.2d 84 (1985).

299. See L. GOLDEN, *supra* note 11, § 5.27. Only Maryland holds to the contrary. See

presumption is based upon a belief that married couples ordinarily expect that jointly titled property will be "ours" rather than "his" or "hers."<sup>300</sup> The correctness of this presumption is purely a policy issue, but the joint title provision suggests that the General Assembly agreed with the presumption when the statute was first enacted.<sup>301</sup> When the new amendments were debated, the legislature focused primarily upon the problems of unitary property, and did not consider or discuss common expectations arising from joint title.<sup>302</sup> The policy question simply was not presented. Until the legislature fully considers the joint title question and deliberately recedes from prior law, the courts should continue to hold that jointly titled assets are completely marital property.

#### IV. PERSONAL INJURY AWARDS

The new amendments also provide new rules for classifying personal injury awards. Cases from other states are split on this topic. Under the mechanistic approach, personal injury awards are always marital property.<sup>303</sup> Under the analytical approach, by contrast, the court divides the award into its component parts. Those parts meant to compensate the marital estate for lost wages and medical expenses are marital property, while those parts meant to compensate the injured spouse for pain and suffering are separate property.<sup>304</sup> Most recent cases have followed the mechanistic approach, reasoning that it is a workable compromise between protecting the marital estate and recognizing the uniquely personal nature of personal injury awards.<sup>305</sup>

The Virginia statute adopts the analytical approach, but modifies the approach in a significant way. Under the new amendments, compensation for lost wages received during the marriage is marital property.<sup>306</sup> The remainder of the award is separate property.<sup>307</sup> The court can order that part of the award be paid to the nonowner, but payments to the nonowner

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Grant v. Zich, 300 Md. 256, 477 A.2d 1163 (1984). Most states only presume a gift, however. See, e.g., McLean v. McLean, 323 N.C. 543, 374 S.E.2d 376 (1988); Trattles v. Trattles, 126 Wis. 2d 219, 376 N.W.2d 379 (Ct. App. 1985). Virginia is the only state which makes all jointly titled assets marital property as a matter of law.

300. See Sharp, *supra* note 128, at 227.

301. VA. CODE ANN. § 20.107.3(A)(2)(i).

302. For instance, the Legislative Subcommittee Analysis, *supra* note 56, does not discuss the policies behind the joint title provision. The Legislative Subcommittee Report, *supra* note 10, also fails to mention the topic.

303. See, e.g., McNeerney v. McNeerney, 417 N.W.2d 205 (Iowa 1987); Orszula v. Orszula, 292 S.C. 264, 356 S.E.2d 114 (1987). See generally L. GOLDEN, *supra* note 11, § 6.25.

304. See, e.g., Campbell v. Campbell, 255 Ga. 461, 339 S.E.2d 591 (1986); Johnson v. Johnson, 317 N.C. 437, 346 S.E.2d 430 (1986); Landwehr v. Landwehr, 111 N.J. 491, 545 A.2d 738 (1988). See generally L. GOLDEN, *supra* note 11, § 6.26.

305. See L. GOLDEN, *supra* note 11, § 6.26.

306. VA. CODE ANN. § 20-107.3(H).

307. *Id.*

can be made only from benefits payable to the owner.<sup>308</sup> Thus, the nonowner's share of a structured award cannot be paid out in an immediate lump sum.

The key difference between the new amendments and the analytical approach is treatment of compensation for medical expenses incurred during the marriage. Under the analytical approach, ordinarily such compensation is marital property, because the expenses were paid with marital funds.<sup>309</sup> In Virginia, however, such compensation is always separate property, regardless of whether marital funds were used to pay the expenses.<sup>310</sup> This rule can easily lead to absurd results. For instance, assume that the parties spend their entire marital estate paying the husband's medical bills. The husband then receives an award compensating him for his injuries, and immediately divorces the wife. Under the new amendments, all of the compensation for medical expenses would be separate property. There would be no marital estate to divide, and the wife would not receive any of the parties' property. This result would shock the conscience of any reasonable observer. The statute should be amended to provide that compensation for medical expenses is marital property if the expenses were paid with marital funds.<sup>311</sup>

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308. *Id.*

309. *See, e.g., Johnson v. Johnson*, 317 N.C. 437, 346 S.E.2d 430 (1986). *See generally* L. GOLDEN, *supra* note 11, § 6.26.

310. VA. CODE ANN. § 20-107.3(H). As originally recommended by the Family Law Section, the bill adopted the overwhelming consensus rule that marital property includes compensation for tangible expenses paid with marital funds. Diehl, *supra* note 85, at I-49. This provision was stricken from the bill before passage by the legislature. *Compare* Diehl, *supra* note 85, at I-49 with VA. CODE ANN. § 20-107.3(H).

311. The statute will not lead to an absurd result in every case, since medical expenses are ordinarily paid by health insurance. Cases will certainly arise, however, in which a substantial amount of medical expenses are not covered by insurance and must be paid from the marital estate. When marital funds have actually been spent to pay the expenses, compensation intended to reimburse the marital estate for those expenses must be marital property. Any other result would penalize the noninjured spouse for complying with his or her legal and moral duty of support.

When the new amendments were under consideration, some legislators apparently expressed concern about cases in which one spouse substantially reduces his work responsibilities and earns significantly less income in order to take care of his injured mate. In such a situation, a substantial part of the personal injury proceeds should be marital property. This fact situation, however, will not arise often. For every case in which one spouse spends his own time caring for the other, there will be many more cases in which marital funds are spent. It is essential, therefore, that marital property include all compensation for medical expenses actually paid with marital funds.

Moreover, the caretaker spouse situation can be resolved reasonably well under existing Virginia law. Under the doctrine of transmutation by implied gift, separate property becomes marital if it is given implicitly to the marital estate. *See supra* note 171-72 and accompanying text. When one spouse spends substantial time caring for the other's injuries, it is unlikely that the parties intended to award the caretaker no compensation whatsoever. Instead, the parties probably intended to create a form of joint enterprise, in which both spouses would share both the burdens and the benefits of caring for the injury. Unless there was clear contrary evidence, therefore, I would resolve the caretaker spouse situation by holding that the separate property portion of the award transmuted by implied gift.

## V. CONCLUSION

A. *Interpreting the Statute: The Lesson of Smoot*

Before leaving *Smoot* to the realm of the legal historian, we should pause briefly to consider the larger picture. The Virginia Supreme Court decided *Smoot* in 1987,<sup>312</sup> five years after the Virginia statute was enacted.<sup>313</sup> Only three years later, in 1990, the General Assembly overruled *Smoot* by general consensus.<sup>314</sup> The new amendments received almost no organized opposition, and passed both houses by substantial margins.<sup>315</sup>

The overwhelming rejection of *Smoot* sheds considerable light upon the legislative intent behind the original Virginia statute. Many members of the 1982 General Assembly were also in the 1990 General Assembly, and nothing between 1982 and 1990 caused sudden recognition that unitary property was wrong.<sup>316</sup> Logically, therefore, the legislature did not change its mind suddenly as to the wisdom of unitary property. Had the question directly arisen in 1982, unitary property would have been rejected as decisively as it was rejected in 1990.

We can learn much about statutory construction by asking why the court in *Smoot* decided that the Virginia General Assembly intended to adopt unitary property. The *Smoot* court's mistaken view of the legislature's intent was not a mere incidental error, but the product of an improper method of interpretation. As initially enacted, the Virginia statute did not expressly adopt either unitary or mixed property.<sup>317</sup> In looking for evidence of the legislature's implicit intent, the *Smoot* court did not ask whether unitary property was wise public policy. Instead, the court microanalyzed the legislature's word choices, and concluded that unitary property was more consistent with the language chosen by the legislature.<sup>318</sup>

*Smoot's* emphasis upon the legislature's word choices stands in contrast to two more recent cases. In *Board of Supervisors v. King Land Corporation*,<sup>319</sup> and again in *Rector and Visitors of the University of Virginia*

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312. *Smoot v. Smoot*, 233 Va. 435, 357 S.E.2d 728 (1987).

313. 1982 VA. ACTS ch. 309.

314. See 1990 VA. ACTS chs. 636, 764. These chapters are identical versions of the new amendments. See *supra* note 6.

315. The Senate version of the new amendments, S. 90, passed the Senate 37-1 and the House 57-34. GENERAL ASSEMBLY INDEX, *supra* note 6. The identical House of Delegates bill, H.B. 606, passed the House 87-10 and the Senate 32-8. *Id.*

316. In other words, a reasonable legislator intending to adopt unitary property would have foreseen most of the problems which actually developed. If property must be all marital or all separate, the marital estate must by definition be either too broad or too narrow. Because he foresaw these problems when he voted for unitary property, a reasonable legislator would not have been distressed when the problems actually occurred, and he would not have voted to amend the statute. A large majority of legislators, however, were distressed by the recent problems and did vote for the new statute. Since the problems of unitary property were all foreseeable, it is unlikely that the legislature originally intended to adopt unitary property.

317. See 1982 VA. ACTS ch. 309.

318. *Smoot v. Smoot*, 233 Va. 435, 441, 357 S.E.2d 728, 731 (1987).

319. 238 Va. 97, 380 S.E.2d 895 (1989).

v. *Harris*,<sup>320</sup> the Virginia Supreme Court stressed that the statutes must be construed in light of the legislative purpose. Defining what it called the "mischief rule,"<sup>321</sup> the *King Land* court held:

Every statute is to be read so as to "promote the ability of the enactment to remedy the mischief at which it is directed." . . . Further, it is a universal rule that statutes such as those under consideration here, which are remedial in nature, are to be "construed liberally, so as to *suppress the mischief* and advance the remedy," as the legislature intended.<sup>322</sup>

Equitable distribution statutes are at least as remedial in nature as the environmental statute construed in *King Land*. *Smoot* was therefore an ideal case for analyzing the alternative constructions in light of the statute's overall equitable purpose.

Failure to conduct such an analysis was *Smoot's* crucial mistake. If the court had applied the "mischief rule" of *King Land* and *Harris*, the result would have been entirely different. Unitary property has been rejected in every other state except Illinois,<sup>323</sup> and it fared so badly there that it was rejected as decisively as it was in Virginia.<sup>324</sup> Even in 1987, the Illinois experience clearly showed that the unitary theory of property did not sufficiently protect commingled nonmarital assets. Unitary property therefore does not advance the statutory purpose, and it could not have withstood analysis under the "mischief rule." By looking to the legislature's word choices rather than the overall equitable purpose behind the statute, the *Smoot* court seriously misread the legislature's intent.

*Smoot's* error should have a noticeable effect upon the way Virginia courts construe the Virginia statute. Until recently, there was a strong tradition in Virginia that courts should apply statutes according to the plain meaning of the statutory words.<sup>325</sup> This guide to interpretation, however, is only helpful when statutory meaning is clear. When the statute is ambiguous, as statutes often are, courts must look to the broad statutory purpose and to any available legislative history.<sup>326</sup>

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320. 239 Va. 119, 387 S.E.2d 772 (1990).

321. *Board of Supervisors v. King Land Corp.*, 238 Va. 97, 99, 380 S.E.2d 895, 897 (1989).

322. 238 Va. at 101-04, 380 S.E.2d at 897-98, quoting *Natrella v. Board of Zoning Appeals*, 231 Va. 451, 461, 345 S.E.2d 295, 301 (1986) (in turn quoting *Jones v. Conwell*, 227 Va. 176, 181, 314 S.E.2d 61, 64 (1984)) and *Shumate's Case*, 56 Va. (15 Gratt.) 653, 661 (1860) (emphasis by *King Land* court).

323. L. GOLDEN, *supra* note 11, § 5.06A.

324. See ILL. ANN. STAT. ch. 40, para. 503(c) (Smith-Hurd Supp. 1990). See generally L. GOLDEN, *supra* note 11, § 5.34; Turner, *supra* note 1, at 861.

325. See, e.g., *Frazier v. City of Norfolk*, 234 Va. 388, 362 S.E.2d 688 (1987); *Ambrogi v. Koontz*, 224 Va. 381, 297 S.E.2d 660 (1982); *School Board of Chesterfield County v. School Board of City of Richmond*, 219 Va. 244, 247 S.E.2d 380 (1978); *Lovosi v. Commonwealth*, 212 Va. 848, 188 S.E.2d 206, *cert. denied*, 407 U.S. 922 (1972).

326. This emphasis upon the legislative purpose when construing ambiguous statutes is

If the plain-meaning rule is used to construe ambiguous statutes, courts will find themselves microanalyzing the legislature's word choices, just as the court did in *Smoot*. This microanalysis leads to inaccurate statutory constructions. The goal of statutory construction, of course, is to determine the intent of the legislature.<sup>327</sup> In order to do this, judges must think like legislators. Legislators, however, place far more weight upon broad policy concerns than they do upon precise language. The courts will therefore construe ambiguous statutes much more accurately if they look to the purpose and history of the statute. This requires the "mischief rule" of *King Land*, not the microanalysis of *Smoot*.

Fortunately, the interpretation of the Virginia statute has been essentially successful. For a good example of statutory construction, we need look no farther than *Lambert v. Lambert*.<sup>328</sup> In that case, the court considered whether separate property transmuted into marital property if it was improved with significant personal effort. Since the *Lambert* court could not overrule *Smoot*, it faced two unappetizing choices. If no transmutation occurred, the marital estate would receive nothing for its contributions; if transmutation did occur, there was a substantial risk that the marital estate would be overcompensated. The *Lambert* court openly

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more common outside Virginia. See, e.g., N. SINGER, *supra* note 86, § 45.09; *Milwaukee County v. Department of Industry*, 80 Wis. 2d 445, 259 N.W.2d 118, 122 (1977) ("the purpose of the whole act is to be sought and is favored over a construction which will defeat the manifest object of the act"). Indeed, no less an authority than the United States Supreme Court has suggested that in some cases, the statutory purpose may even prevail over the statute's literal wording:

Where the words are ambiguous, the judiciary may properly use the legislative history to reach a conclusion. *And that method of determining congressional purpose is likewise applicable when the literal words would bring about an end completely at variance with the purpose of the statute.*

*United States v. Public Util. Comm. of Ca.*, 345 U.S. 295, 315 (1953) (emphasis added). Compare with this statement the dissenting opinion of Chief Justice Carrico in *Rector and Visitors of the Univ. of Va. v. Harris*, 239 Va. 119, 387 S.E.2d 772 (1990):

[T]his court is confined to the language the General Assembly used in attempting to deal with the mischief, and, if that language is insufficient for the purpose, so be it.

239 Va. at 126, 387 S.E.2d at 776 (Carrico, C.J., dissenting). With all respect, Chief Justice Carrico would have made the same mistake in *Harris* which the court had already made in *Smoot*. It is unquestionable that the primary rule of statutory construction is to determine the intent of the legislature. See *infra* note 327. If the legislature clearly intends to reach a certain result, the court should implement that result, regardless of whether the legislature's draftsmanship meets some objective minimum standard of clarity. Ignoring the legislative intent thwarts the will of the majority in a manner wholly inconsistent with Virginia's tradition of judicial restraint. Virginia courts need to stop placing so much emphasis upon the legislature's precise word choices, and start placing more emphasis upon the legislative purpose. Both *Harris* and *Lambert* are excellent steps in the right direction.

327. See, e.g., *Virginia Dept. of Labor and Industry v. Westmoreland Coal Co.*, 233 Va. 97, 353 S.E.2d 758 (1987); *Harward v. Commonwealth*, 229 Va. 363, 330 S.E.2d 89 (1985); *Graybeal v. Commonwealth*, 228 Va. 736, 324 S.E.2d 698 (1985); *Vollin v. Arlington County Electoral Bd*, 216 Va. 674, 222 S.E.2d 793 (1976).

328. 6 Va. App. 94, 367 S.E.2d 184 (1988).

looked to the purpose of the statute, and concluded that enhancing the marital estate would yield a more equitable distribution of the parties' property.<sup>329</sup> The court reached this result even though the statute could reasonably be read as providing that all appreciation in separate property remained separate.<sup>330</sup> *Lambert* is therefore an excellent example of a court emphasizing the statute's broad remedial purpose over microanalysis of the legislature's word choices.

When we look at the new amendments, we see that *Lambert* has generally fared quite well. Active appreciation no longer causes complete transmutation,<sup>331</sup> of course, but that is not a defeat for *Lambert*. The *Lambert* court would probably have jumped at the opportunity to classify only the amount of active appreciation as marital property, if that option had been consistent with *Smoot*. The core of *Lambert* is its recognition that the marital estate has some interest in actively appreciated separate property, and that part of its holding has now been codified.<sup>332</sup> The new amendments change the amount of the remedy, but they do not alter the basic concept.

The contrast between *Smoot* and *Lambert* is overwhelming. *Smoot* used a plain-meaning approach to construe an ambiguous statute, and it was overwhelmingly rejected only three years after it was decided. *Lambert* looked to the broad statutory purpose, and the fundamental part of its holding was written into the new statute. There is a clear lesson here for the Virginia courts to consider. If courts refuse to look at the broad statutory purpose when interpreting ambiguous statutes, their decisions will be inconsistent with the legislative intent. Future Virginia decisions should construe § 20-107.3 under the broad purpose-based analysis of *Lambert* and *King Land*.

### *B. Defining Marital Property: The Unitary Property Experience*

Most recent commentators on equitable distribution have argued for a broad definition of marital property.<sup>333</sup> This argument is unquestionably correct, because a large marital estate gives the trial judge maximum flexibility to reach an equitable result. Nevertheless, if followed to its logical extreme, the broad marital estate argument would swallow the

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329. *Lambert v. Lambert*, 6 Va. App. 94, 106, 367 S.E.2d 184, 190 (1988).

330. See VA. CODE ANN. § 20-107.3(A)(1) (1980) (repealed 1990) (stating without apparent qualification that appreciation in separate property is itself separate property).

331. VA. CODE ANN. § 20-107.3(A)(1) (when property actively appreciates, only the appreciation itself is marital property).

332. VA. CODE ANN. § 20-107.3(A)(1).

333. See, e.g., Reynolds, *supra* note 13; Sharp, *supra* note 128, at 248; Sharp, *Equitable Distribution of Property in North Carolina: A Preliminary Analysis*, 61 N.C.L. REV. 247, 249 (1983) ("Neither the statutory distributional factors nor judicial wisdom can effectuate a fair division of marital property unless that property is defined fairly in the first instance").



entire dual classification system of equitable distribution.<sup>334</sup> Marital property must be defined broadly, but there must be limits on the size of the marital estate.

Virginia's experience under unitary property shows well the dangers of an overbroad definition of marital property. At the classification stage, unitary property was unquestionably generous to the marital estate, and trial judges had more than enough marital property to divide. The system broke down, however, at the division stage. Because the pool of marital property was so large, the ultimate property division depended mostly upon the trial judge's discretion. The discretionary standard caused unpredictability, inconsistency, and increased litigation.<sup>335</sup> The resulting inequity offset substantially the benefits of a broad definition of marital property.

A broad marital estate, therefore, is not the ultimate goal of equitable distribution. Every property division case poses hard questions of public policy. When the court broadens the definition of marital property, it does not really answer those questions. Instead, it merely shifts the responsibility for answering them from the classification stage to the division stage.<sup>336</sup> This shift has substantial policy effects, because it shifts the review standard from independent judgment to abuse of discretion.<sup>337</sup> As the Virginia experience shows, the discretionary standard yields uncertain, unpredictable, and ultimately inequitable answers to equitable distribution questions.

There are certainly some property division issues that are best suited for discretionary review.<sup>338</sup> Many policy issues, however, must receive a

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334. Under a dual-classification system, the court can divide only marital property. If the definition of marital property is expanded as far as possible, all of the parties' property would be divisible, and there would not be a dual-classification system at all. Legislative adoption of a dual-classification rather than an all-property system necessarily implies some role for separate property.

335. See *supra* notes 51-54 and accompanying text.

336. For example, assume that the husband's separate property business increases in value during the marriage. The increase was due to two factors: the husband's expertise, and the long hours he spent improving the business. The husband was able to spend those long hours on the business only because the wife was a full-time homemaker.

This situation poses a very difficult policy question: the extent to which the wife should share in an increase directly caused by the husband's efforts. Regardless of how the court handles the case, it must eventually address this question. If the court classifies the appreciation as part marital and part separate property, it will be answering the policy question mostly at the classification stage. If the court classifies the entire increase as marital property, the difficult question has been avoided at the classification stage. The husband will undoubtedly argue, however, that he should get more than 50% of the appreciation because most of it came from his efforts. Thus, classification of the increase as marital property has not answered the policy question. It has only postponed resolution of that question from the classification stage to the division stage.

337. Classification of property as marital or separate is an issue of law, upon which the appellate court independently reviews the trial court's judgment. Division of marital property is an issue of fact, and the trial court's decision is reversed only for an abuse of discretion. See, e.g., *Thomas v. Thomas*, 259 Ga. 73, 78, 377 S.E.2d 666, 670 (1989).

338. Questions of which spouse contributed how much to the marriage are particularly

uniform and consistent answer.<sup>339</sup> Such an answer cannot be given under a discretionary review standard. On issues where consistency and uniformity are needed, therefore, the appellate courts should not limitlessly broaden the definition of marital property. Instead, appellate courts should strive to create workable rules of law for measuring the marital and separate interests. Virginia's experience shows the best way to maintain consistency is to recognize partial marital and separate interests. If the court classifies the entire asset as marital and relies upon the trial judge to reach an unequal division, the result will be uncertainty and chaos.

We must, therefore, strike a balance between an overly broad and an overly narrow definition of marital property. This balancing test makes intuitive sense. At its heart, the dual classification model is an attempt to protect the property rights of both parties in a consistent and predictable manner.<sup>340</sup> This goal is not achieved if the appellate courts defer all the difficult questions to the trial court by defining marital property too broadly. The appellate courts should instead confront the difficult questions directly, by adopting appropriate definitions of marital and separate property. Any property in which both spouses have valid interests should be marital property. By enacting a dual classification statute, however, the legislature has declared that some types of property should be awarded to the owning spouse. Where these types of property are involved, the courts should not hesitate to find that asset to be separate property.

There is a fine line, of course, between defining the marital estate broadly and defining it too broadly. The line can be seen most clearly by looking at how we expect marital property to be divided. If there is a

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well resolved as questions of fact. *See, e.g., Aster v. Gross*, 7 Va. App. 1, 371 S.E.2d 833 (1988) (trial courts have particular discretion when considering and balancing statutory equitable distribution factors). Conversely, one of the main purposes of a dual classification system is to ensure that certain types of property are immune from division. Thus, where the question is whether or not an asset is immune from division, a question of law is presented. *Thomas v. Thomas*, 259 Ga. 73, 377 S.E.2d 666 (1989); *Campion v. Campion*, 385 N.W.2d 1 (Minn. Ct. App. 1986); *Schwegler v. Schwegler*, 142 Wis. 2d 362, 417 N.W.2d 420 (Ct. App. 1987).

339. For example, the role of contributions to maintenance in active appreciation is a recurring equitable distribution question. Although the amount of contributions to maintenance in any particular case is a question of fact, the degree to which such contributions can cause active appreciation is an issue of law. If it is not given a single consistent answer, the courts will reach disparate results in similar fact situations.

Accordingly, courts should not simply define all contributions to maintenance as marital contributions for purposes of active appreciation. Such a definition would simply move the difficult policy question from the classification stage to the division stage. At the division stage, the trial court's decision would be reviewed on an abuse of discretion basis, and the decisions would quickly become inconsistent. Instead of overbroadening the marital estate, the court should determine as a matter of law the role of contributions to maintenance in creating active appreciation, and classify the appreciation as part marital and part separate property. Because the trial court's classification of appreciation is a question of law subject to independent review on appeal, this method of making the decision ensures a consistent and uniform rule on the role of contributions to maintenance.

340. *See supra* notes 35-39.

general policy consensus that an asset should be divided roughly equally in most cases, it should be classified as marital. If we expect an asset to be divided substantially unequally, however, we are asking for trouble if we classify that asset as marital.<sup>341</sup> Because of the discretionary review standard, there is no guarantee that trial judges will make the desired

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341. Surprisingly, few recent commentators recognize this fact. Instead, most commentators argue for a broad definition of marital property at the classification stage, while assuming that the division stage will take care of itself. *See, e.g.*, Reynolds, *supra* note 13 (arguing for broad definition of marital property, without discussing what happens at division stage).

Virginia's experience under unitary property reminds us how closely the classification and division stages are linked. We cannot simply classify all disputed assets as entirely marital property, and congratulate ourselves for a job well done. If there is a legitimate reason to award the asset disproportionately to the owning spouse, trial judges will divide the asset unequally in at least some cases. By defining marital property overbroadly, therefore, we have only deferred the ultimate question until the division stage—the stage least suited to resolving it fairly and consistently.

An excellent example of an overbroad definition of marital property is the principle that all appreciation in separate property should be classified as marital. While most states have rejected this position, a leading commentator recently embraced the position that all appreciation in separate property should be classified as marital. *See* Wenig, *The Increase in Value of Separate Property During Marriage*, 23 FAM. L.Q. 301 (1989). Wenig concludes that distinguishing active from passive appreciation is too difficult, and that all appreciation should therefore be marital property. Wenig, *supra*, at 330-337. Wenig's position would be workable at the classification stage, but it would cause serious problems at the division stage. Even if passive appreciation cannot efficiently be identified, there are still solid common-sense reasons why appreciation caused by inflation should be separate property. Wenig herself may recognize this, for she reassures us that trial judges still have the flexibility to make unequal divisions. Wenig, *supra*, at 337. Following this suggestion, judges applying Wenig's system would probably divide the appreciation in many separate assets unequally, reasoning that the nonowner is not entitled to 50% of the appreciation caused by inflation. Because of the discretionary review standard, trial judges would likely reach inconsistent results on the same facts, and it would be largely impossible to predict how any court would treat appreciated separate property. Unfortunately, therefore, Wenig's attempt to avoid the difficult question of distinguishing active from passive appreciation would merely defer it to the division stage. Ironically, the ultimate result could well be less uniformity and predictability than in the present system—the exact opposite of Wenig's stated goals.

Of course, inconsistency would not be a problem if trial judges were content to divide all appreciation equally. The concept of passive appreciation, however, is rooted deeply in basic principles of equity. If we are going to have separate property to begin with, it should not be lost merely because of inflation. The basic equity of distinguishing active from passive appreciation is clear from the fact that almost every dual-classification jurisdiction makes the distinction. *See generally* L. GOLDEN, *supra* note 11, § 5.39. Any expectation that trial judges will be content to divide appreciation equally in all cases is therefore wishful thinking.

The above example demonstrates well one additional facet of defining marital property. In determining whether we expect marital property to be divided equally or unequally, we must be reasonable in our expectations. If dividing a certain asset unequally makes sense, then trial judges will divide it unequally at the division stage in at least some cases. These unequal divisions will not be uniform, and the law will be inconsistent and inequitable. Therefore, when there is substantial reason to divide an asset unequally in most cases, we should define part of the asset as separate property. Defining it as entirely marital property will cause more problems at the division stage than it would solve at the classification stage.

unequal division. Even if most judges do divide the asset unequally, there will still be no consistency or uniformity to the amount of inequality.<sup>342</sup> Any legislature enacting a dual classification system has expressed its desire that the property division system be to some extent predictable.<sup>343</sup> If this goal is to be attained, courts should not regularly ask trial judges to make unequal divisions. Marital property should therefore not include any asset we expect to divide unequally in a large number of cases.<sup>344</sup>

### C. The New Amendments

The new amendments are an attempt to limit *Smoot's* overbroad definition of marital property. By defining all commingled assets as marital property, *Smoot* included many traditionally separate assets in the marital estate. This refusal to protect separate property deferred the hard questions of property division from the classification stage to the division stage. Not surprisingly, the resulting trial court decisions were inconsistent and arbitrary.

Under the new amendments, the hard questions will return to the classification stage. The task of the appellate courts will be harder, for appellate judges must now face difficult questions of law involving appreciated property and the source of funds rule. Until the courts have outlined the basic parameters of the new law, there will be confusion and uncertainty.

In the long run, however, Virginia's equitable distribution law could improve significantly. Courts will focus more upon the real policy issues, and less upon arcane questions of commingling and transmutation. The law will be more predictable, making settlements easier to reach. Most important, division of assets will become much more uniform and much

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342. See *supra* notes 51-54 and accompanying text.

In addition, an overbroad definition of marital property may actually hurt the interests of nonowning spouses. One of the basic unstated assumptions of equitable distribution is that in most cases, most of the assets should be divided approximately equally. When we start encouraging unequal divisions, this notion starts to decay. By approving an unequal division in one case, we are unavoidably approving of unequal divisions in general, and increasing the risk that trial courts will divide marital property unequally in cases where the division should be equal. This does not mean that all unequal divisions are wrong, but it does mean that all unequal divisions have a potential for harm. If our definition of marital property includes assets we expect to be divided unequally in most cases, this harm is maximized. In order to minimize the number of improperly unequal divisions, we should minimize our reliance upon unequal divisions across the board.

343. See *supra* notes 37-38 and accompanying text.

344. This is not an argument against recognizing small marital interests. The marital interest should not be ignored merely because it is less than half of the value of the asset.

We must, however, be careful about the *method* we choose for recognizing small marital interests. If we classify the entire asset as marital and ask the trial judge to make an unequal division, the decisions will be inconsistent and unpredictable. Instead of classifying the whole asset as marital, we should classify the asset as part marital and part separate property. This recognizes both interests in a consistent and predictable manner, while preserving the general principle that most marital property should be divided approximately equally in most cases.

less inconsistent. These changes can potentially increase the overall equity of most property divisions.

It is important, of course, that the courts interpret the new amendments in light of their purpose. That purpose was not to limit the rights of the nonowner, but to remove traceable commingled separate property from the marital estate.<sup>345</sup> The drafters clearly intended that the spouses share all legitimate products of the marital partnership, as shown by the express adoption of the active appreciation rule and the broad definition of personal effort.<sup>346</sup> Thus, while the new amendments are individualistic, the amendments restrict broad principles of sharing only in the context of traceable commingled property. As long as the courts recognize the importance of sharing and continue to define marital property broadly, the new amendments will result in better decisions for both spouses.

In my earlier article, I concluded that the success of Virginia's pre-1990 equitable distribution law depended upon the wisdom of the state's trial judges.<sup>347</sup> By contrast, the success of the new amendments depends upon the wisdom of the state's appellate judges. Future appellate courts interpreting the new amendments must walk a narrow path between an overly narrow and an overly broad definition of marital property. If the Supreme Court and the Court of Appeals respond to the challenge, Virginia can be a leading state in the law of equitable distribution.

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345. The list of legislative goals in Legislative Subcommittee Report, *supra* note 10, makes no mention of limiting the marital estate. A listing of goals after the fact in an article by the chairman of the legislative subcommittee similarly does not mention any intent to restrict marital property. *See* Diehl, *supra* note 85, at I-5 to I-6. The new legislation "is only intended to 'tame' the harsh and extreme rulings of Virginia's transmutation case law." Diehl, *supra* note 85, at I-6.

346. VA. CODE ANN. § 20-107.3(A)(1) & (3).

347. Turner, *supra* note 1, at 862.

## APPENDIX I

REPORT AND RECOMMENDATIONS ON THE ISSUE  
OF TRANSMUTATION AND CLASSIFICATION OF  
PROPERTY IN EQUITABLE DISTRIBUTION  
PROCEEDINGS BY

Legislative Subcommittee, Family Law Section  
Board of Governors, Virginia State Bar  
Lawrence D. Diehl, Hopewell, Virginia  
Chairman of Subcommittee

FINAL REPORT  
September 29, 1989

REPORT AND RECOMMENDATIONS ON THE  
ISSUE OF TRANSMUTATION/CLASSIFICATION OF PROPERTY  
IN EQUITABLE DISTRIBUTION PROCEEDINGS

BY

Family Law Section,  
Board of Governors, Virginia State Bar  
Lawrence D. Diehl, Marks & Harrison, Hopewell, Va.  
Chairman of Legislative Subcommittee

I. *STATEMENT OF THE PROBLEM:*

The status of the law of property classification and transmutation pursuant to § 20-107.3 is in chaos due to the ruling of the Virginia Supreme Court in *Smoot v. Smoot*, and subsequent cases. There is virtually no guidance to trial courts and practitioners. Our transmutation law is more overbroad than that of any other equitable distribution state, and there is virtually an unfettered discretion resulting from such cases in the division of marital property by the trial court which has caused confusion and inconsistent results in court cases.

In the case of *Smoot v. Smoot*, 213 Va. 435, 357 S.E.2d 728 (1987), the Virginia Supreme Court adopted the "unitary theory" of property classification pursuant to § 20-107.3 of the Code. Despite court rulings or legislation in most other common law states adopting the "source of funds" rule, to similar statutory language allowing "dual classification," and thus, more definite credits and rules as to the division of marital property, the Court held that property in Virginia divorce proceedings was either all marital, or all separate, and that even "insignificant" actions could transmute property from separate to marital property.

Subsequent case law in Virginia has also held that, despite the clear language of the statute, that "active appreciation" of the value of separate property due to the efforts of the spouses during marriage transmutes the entire separate property to marital, thus giving the court the discretion to divide the property as it sees fit in accordance with the statutory factors of § 20-107.3(E). See, e.g., *Lambert v. Lambert*, 6 Va. App. 94, 367 S.E.2d 184 (1988); *Ellington v. Ellington*, 8 Va. App. 48, 378 S.E.2d 626 (1989). Other cases dealing with the issue of credits for contributions to the acquisition of marital property by payment of money from separate property sources have left inconsistent results, some providing a full credit to the contributing spouse, *Pommerenke v. Pommerenke*, 7 Va. App. 241, 372 S.E.2d 630 (1988), some providing some credits or a division considering monetary contributions in part, *Aster v. Gross*, 7 Va. App. 1, 371 S.E.2d 833 (1988), and some rejecting a full credit where the contribution is clearly traceable to the contributing spouse, *Ellington, supra*. More recent cases such as *Lassen v. Lassen*, 6 VLR 125 (8/8/89) and *Taylor v. Taylor*, 6 VLR 171 (8/8/89, opinion withdrawn 9/8/89), further show the inequitable results of the mere commingling of separate property

with marital bank accounts where a clear retracing of the separate property with marital bank accounts where a clear retracing of the separate property was presented by the evidence.

The results of all of these have been criticized by family law practitioners due to the following reasons:

- (1) Inconsistent court results with similar fact situations.
- (2) A theory of transmutation that is as broad as any in the country due to the *Smoot* ruling, which theory is arguably inconsistent with the marital partnership theory.
- (3) Lack of standards as to what activities are sufficient to permit transmutation of separate property.
- (4) Lack of guidance on when a "source of funds" credit will be given to a contributing spouse in the ultimate monetary award or division of property even if transmutation of separate property to marital property has occurred.
- (5) Inability to counsel clients on their reasonable property expectations, even in the most simple of equitable distribution cases due to the complete and broad discretion now vested in the trial court as to their ultimate ruling in such matters.

In summary, the state of § 20-107.3, the equitable distribution statute as it relates to property classification, transmutation, and definite ground rules for even the most simple of divorce cases is in chaos due to the ruling in *Smoot*, and the post-*Smoot* cases.

For further articles and publications setting forth the problem, see the following items attached hereto as "*Background Materials*":

1. "Transmutation in Virginia: Legislative Approaches In Response to *Smoot*," Diehl, 9 *Family Law News*, No. 3 (Winter 1988-89).
2. "Analysis of the *Ellington* Case," Diehl, *Family Law News Alert*, No. 1 (April, 1989).
3. "Appeals Court Fine-Tunes Equitable Distribution," Virginia Lawyers Weekly, 017 (689).
4. Upcoming publication, Diehl, "Transmutation in Virginia: Are We Drowning in the Pool of Marital Assets," *VTLA Journal* (Fall 1989 Edition).
5. Family Law Notes #7, 11 and 13, National Legal Research Group.
6. Chart analysis of Transmutation Cases and % of Distribution Cases prepared by Lawrence D. Diehl. (There were included in Seminar materials presented in Fall, 1988 Virginia State Bar CLE Program and July, 1989 VTLA Annual Family Law Seminar).
7. "Taming Transmutation"—*Illinois Bar Journal*, Article analyzing Illinois statutory language upon which part of Virginia Statute is based.
8. Upcoming Publication; Diehl, "Update On Transmutation: Analysis of *Lassen* and *Taylor* Cases," *Virginia Bar Journal* (Fall 1989 Edition).

## II. STATEMENT OF THE LEGISLATIVE GOALS OR NEEDS TO RESPOND TO SMOOT:



In order to respond to the numerous effects and implications of the *Smoot* case, a comprehensive revision to the statutory language of § 20-107.3 will be needed.

Any statutory revisions, responding to the problems specified above, should, at a minimum, include the following:

1. A modification of the "unitary theory" of property classification, by a "source of funds" classification statute which uses a marital partnership theory as its basis.
2. An articulation of property classification to permit the trial court to classify property based upon the "source of funds" concept which is used in virtually all other common law classification states.
3. A more definite articulation of those circumstances when credits or reimbursements for contributions by a spouse from their separate property will be made to provide more guidance to practitioners and the trial courts on such issues.
4. A statutory classification concept that recognizes the "marital partnership theory," including the personal efforts of either or both of the parties during the marriage that have resulted in the economic benefit to the marriage.
5. A statutory classification concept that preserves the integrity of the separate property of a spouse where only passive appreciation has increased its value, and a further specific response to the *Lambert* and *Ellington* cases by preventing transmutation unless the efforts of the spouses are substantial and result in significant appreciation of the separate property.
6. To the extent possible, a statutory revision that is readable, provides definite guidelines on reimbursement and classification issues consistent with the "marital partnership" theory, and contains such revision in a consolidated area of the Code.

### III. SCOPE OF THE STUDY AND BACKGROUND RESEARCH:

The subcommittee began its research into the area in the Fall of 1988 by reviewing all Virginia case law on the subject, and the extensive legislative revisions that responded to a similar classification problem in the state of Illinois. Recent requests by Del. William Axelle, Del. Sam Glascock, Del. "Chip" Dicks and Del. Glen Crowshaw have also requested this subcommittee to study this issue. Background materials included the outline on Transmutation that was presented in the Fall CLE lecture, 1988, by the Virginia State Bar, prepared by Lawrence Diehl of Hopewell and Frank Morrison of Lynchburg. Richard Crouch of the subcommittee provided numerous articles on the Illinois response to their transmutation/classification problems for the committee's review. Lawrence Diehl researched the statutes of numerous other common law equitable distribution states, as well as a review of the Uniform Marital Property Act and articles interpreting the provisions

of these statutes contained in treatises, Law Review Articles and the Equitable Distribution Law Journal.

Due to the fact that the only other state that had a similar problem in its property classification due to court rulings was Illinois, and the fact that they had responded to the same issue through use of a "reimbursement" theory type of statutory response, a careful review of their statute and articles relating to its implementation and effects in Illinois was made. Case law examined by the sub-committee in Illinois appeared to properly respond to the statute and more fairly recognized the marital contributions of the parties, credits for traceable reimbursements and responded to the harsh results of previous transmutation cases. However, the committee has further studied a possible classification level approach to the problem in order to resolve the problem at a classification level, using the Illinois approach as a basic starting point.

On July 27, 1989, after approximately one year of study and meetings, the subcommittee made certain preliminary recommendation on the issue. After further study, on September 29, 1989, at the Board of Governors meeting, the full board adopted a recommendation to pursue the enactment of a "source of funds" statutory amendment to § 20.107.3, which amendment was identified as "Option B" in the subcommittee's preliminary report of July 27, 1989.

#### IV. RECOMMENDATIONS OF THE BOARD OF GOVERNORS:

There is absolutely no question that legislation is needed to make sense out of an area of the law that has gotten out of hand through the broad rulings of court cases of transmutation and property division resulting from *Smoot*. Unless legislation is enacted, continued lack of definite rules, overbroad discretions with the trial courts and unfair cases of transmutation will continue to provide virtually no guidance to practitioners and the courts in fairly advising clients as to their reasonable expectations in such cases. Litigation will continue on issues that should and could be resolved by providing definite ground rules in such areas as credits for contributions from separate property, commingling of assets and issues of transmutation of separate property due to the personal efforts of the parties, where no standard for such efforts has been articulated by courts.

Further, such legislation would not be inconsistent with the original goals of the concept of equitable distribution as enacted in 1982, but would provide the guidance needed by the courts and practitioners resulting from the unexpected ruling in *Smoot*, which is arguably inconsistent with the legislative goals set forth in the initial legislative history on the subject.

In order to fully and comprehensively respond to the issue, the Board of Governors of the Family Law Section recommends the enactment of an amendment to § 20-107.3 which is attached hereto as "Option

*B,*” and which is an outright rejection of the unitary theory of classification of property created by *Smoot*.

While recognizing the amendment as comprehensive, it is the Board’s belief that the legislation is clear, provides proper standards of proof, is responsive to the needs addressed in this report to the degree necessary, and is consistent with the original intent of the enactment of § 20-107.3 to provide a fair marital partnership recognition to property disputes in divorces.

## APPENDIX II

COMMENTS AND ANALYSIS OF PROPOSED  
AMENDMENTS TO § 20-107.3 RELATING TO  
DEFINITION OF MARITAL AND SEPARATE  
PROPERTY  
IN EQUITABLE DISTRIBUTION PROCEEDINGS

by

Lawrence D. Diehl, Chairman  
Legislative Subcommittee  
Board of Governors  
Family Law Section  
Virginia State Bar

SP1069125

1990 SESSION  
ENGROSSED

## SENATE BILL NO. 90

Senate Amendments in [ ] - January 29, 1990

A BILL to amend and reenact § 20-107.3 of the Code of Virginia, relating to equitable distribution.

Patron—Michie

Referred to the Committee for Courts of Justice

Be it enacted by the General Assembly of Virginia:

1. That § 20-107.3 of the Code of Virginia is amended and reenacted as follows:

§ 20-107.3. Court may decree as to property of the parties.—A. Upon decreeing the dissolution of a marriage, and also upon decreeing a divorce from the bond of matrimony, or upon the filing with the court as provided in subsection I of a certified copy of a final divorce decree obtained without the Commonwealth, the court, upon request of either party, shall determine the legal title as between the parties, and the ownership and value of all property, real or personal, tangible or intangible, of the parties and shall consider which of such property is separate property and , which is marital property ,and which is part separate and part marital property in accordance with subdivision A 3 . The court shall determine the value of any such property as of the date of the evidentiary hearing on the evaluation issue. Upon motion of either party made no less than twenty-one days before the evidentiary hearing the court may, for good cause shown, in order to attain the ends of justice, order that a different valuation date be used. The court, on the motion of both parties, may retain jurisdiction in the final decree of divorce to adjudicate the remedy provided by this section when the court determines that such action is clearly necessary because of the complexities of the parties' property interests, and all decrees heretofore entered retaining such jurisdiction are validated.

1. Separate property is (i) all property, real and personal, acquired by either party before the marriage; (ii) all property acquired during the marriage by bequest, devise, descent, survivorship or gift from a source other than the other party; and (iii) all property acquired during the marriage in exchange for or from the proceeds of sale of separate property, provided that such property acquired during the marriage is maintained as separate property ; and (iv) that [ portion part ] of any property classified as [ part ] separate pursuant to subdivision A 3 . Income received from ; and the increase in value of, separate property during the marriage is separate property separate property during the marriage is separate property if not attributable to the personal effort of either party. The increase in value of separate property during the marriage is separate property, unless marital property [ ; including or ] the personal efforts of either party, have contributed to such increases and then only to the extent of [ the increases in value attributable to ] such contributions. The personal efforts of either party must be significant and result in substantial appreciation of the separate property if any [ income or ] increase in value attributable thereto is to be considered marital property .

2. Marital property is (i) all property titled in the names of both parties, whether as joint tenants, tenants by the entirety or otherwise, and (ii) that [ portion part ] of any property classified as [ part ] marital pursuant to subdivision A 3, or (iii) all other property acquired by each party during the marriage which is not separate property as defined above. All property including that portion of pensions, profit-sharing or deferred compensation or retirement plans of whatever nature, acquired by either spouse during the marriage, and before the last separation of the parties, if at such time or thereafter at least one of the parties intends that the separation be permanent, is presumed to be marital property in the absence of satisfactory evidence that it is separate property. For purposes of this section marital property is presumed to be jointly owned unless there is a deed, title or other clear indicia that it is not jointly owned.

[ 3. ] The court shall classify property as part marital property and part separate

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(1) *property as follows:*

COMMENT #7

(2) *a. In the case of income received from separate property during the marriage, such*  
 (3) *income shall be marital property only to the extent it is attributable to the personal*  
 (4) *efforts of either party [ and in . In ] the case of the increase in value of separate*  
 (5) *property during the marriage, such increase in value shall be marital property only to the*  
 (6) *extent that marital property [ : including or ] the personal efforts of either party, have*  
 (7) *contributed to such increases, provided that any such personal efforts must be significant*  
 (8) *and result in substantial appreciation of the separate property.*

COMMENT #9

(9) *b. In the case of any pension, profit-sharing, or deferred compensation plan or*  
 (10) *retirement benefit, the marital share as defined in subsection G shall be marital property.*

COMMENT #10

(11) *c. In the case of any personal injury or workers' compensation recovery of either*  
 (12) *party, the marital share as defined in subsection H of this section shall be marital*  
 (13) *property.*

COMMENT #11

(14) *d. When marital property and separate property are commingled by contributing one*  
 (15) *category of property to another, resulting in the loss of identity of the contributed*  
 (16) *property, the classification of the contributed property shall be transmuted to the category*  
 (17) *of property receiving the contribution. However, to the extent the contributed property is*  
 (18) *retraceable by a preponderance of the evidence and was not a gift, such contributed*  
 (19) *property shall retain its original classification.*

COMMENT #12

(20) *e. When marital property and separate property are commingled into newly acquired*  
 (21) *property resulting in the loss of identity of the contributing properties, the commingled*  
 (22) *property shall be deemed transmuted to marital property. However, to the extent the*  
 (23) *contributed property is retraceable by a preponderance of the evidence and was not a gift,*  
 (24) *the contributed property shall retain its original classification.*

COMMENT #13

(25) *[ For purposes of this section, personal effort of a party during the marriage shall be*  
 (26) *deemed a contribution by the marital estate. ] "Personal effort" of a party shall be*  
 (27) *deemed to be labor, effort, inventiveness, physical or intellectual skill, creativity or*  
 (28) *managerial activity, promotional or marketing activity, applied directly to the separate*  
 (29) *property of either party.*

(30) *B. For the purposes of this section only, both parties shall be deemed to have rights*  
 (31) *and interests in the marital property ; however, . However, such interests and rights shall*  
 (32) *not attach to the legal title of such property and are only to be used as a consideration in*  
 (33) *determining a monetary award, if any, as provided in this section.*

(34) *C. The court shall have no authority to order the division or transfer of separate*  
 (35) *property or marital property which is not jointly owned. The court may, based upon the*  
 (36) *factors listed in subsection E, order the division or transfer, or both, of jointly owned*  
 (37) *marital property, or any part thereof.*

(38) *As a means of dividing or transferring the jointly owned marital property, the court*  
 (39) *may (i) order the transfer of real or personal property or any interest therein to one of*  
 (40) *the parties, (ii) permit either party to purchase the interest of the other and direct the*  
 (41) *allocation of the proceeds, provided the party purchasing the interest of the other agrees to*  
 (42) *assume any indebtedness secured by the property, or (iii) order its sale by private sale by*  
 (43) *the parties, through such agent as the court shall direct, or by public sale as the court*  
 (44) *shall direct without the necessity for partition.*

(45) *D. In addition, based upon (i) the equities and the rights and interests of each party in*  
 (46) *the marital property, and (ii) the factors listed in subsection E, the court has the power to*  
 (47) *grant a monetary award, payable either in a lump sum or over a period of time in fixed*  
 (48) *amounts, to either party. The party against whom a monetary award is made may satisfy*  
 (49) *the award, in whole or in part, by conveyance of property, subject to the approval of the*  
 (50) *court. An award entered pursuant to this subsection shall constitute a judgment within the*  
 (51) *meaning of § 8.01-426 and shall not be docketed by the clerk unless the decree so directs.*  
 (52) *The provisions of § 8.01-382, relating to interest on judgments, shall apply unless the court*  
 (53) *orders otherwise.*

(54) *Any marital property, which has been considered or ordered transferred in granting the*

1 monetary award under this section, shall not thereafter be the subject of a suit between  
2 the same parties to transfer title or possession of such property.

3 E. The amount of any division or transfer of jointly owned marital property, and the  
4 amount of any monetary award, and the method of payment shall be determined by the  
5 court after consideration of the following factors:

6 1. The contributions, monetary and nonmonetary, of each party to the well-being of the  
7 family;

8 2. The contributions, monetary and nonmonetary, of each party in the acquisition and  
9 care and maintenance of such marital property of the parties;

10 3. The duration of the marriage;

11 4. The ages and physical and mental condition of the parties;

12 5. The circumstances and factors which contributed to the dissolution of the marriage,  
13 specifically including any ground for divorce under the provisions of § 20-91 (1), (3) or (6)  
14 or § 20-95;

15 6. How and when specific items of such marital property were acquired;

16 7. The debts and liabilities of each spouse, the basis for such debts and liabilities, and  
17 the property which may serve as security for such debts and liabilities;

18 8. [Repealed.]

19 9. The liquid or nonliquid character of all marital property;

20 10. The tax consequences to each party; and

21 11. Such other factors as the court deems necessary or appropriate to consider in order  
22 to arrive at a fair and equitable monetary award.

23 F. The court shall determine the amount of any such monetary award without regard to  
24 maintenance and support awarded for either party or support for the minor children of  
25 both parties and shall, after or at the time of such determination and upon motion of  
26 either party, consider whether an order for support and maintenance of a spouse or  
27 children shall be entered or, if previously entered, whether such order shall be modified or  
28 vacated.

29 G. In addition to the monetary award made pursuant to subsection D, and upon  
30 consideration of the factors set forth in subsection E, the court may direct payment of a  
31 percentage of the marital share of any pension, profit-sharing or deferred compensation  
32 plan or retirement benefits, whether vested or nonvested, which constitutes marital property  
33 and whether payable in a lump sum or over a period of time. However, the court shall  
34 only direct that payment be made as such benefits are payable. No such payment shall  
35 exceed fifty percent of the marital share of the cash benefits actually received by the  
36 party against whom such award is made. "Marital share" means that portion of the total  
37 interest, the right to which was earned during the marriage and before the last separation  
38 of the parties, if at such time or thereafter at least one of the parties intended that the  
39 separation be permanent.

( 40 H. In addition to the monetary award made pursuant to subsection D, and upon  
( 41 consideration of the factors set forth in subsection E, the court may direct payment of a  
( 42 percentage of the marital share of any personal injury or workers' compensation recovery  
( 43 of either party, whether such recovery is payable in a lump sum or over a period of time.  
COMMENT #14 ( 44 However, the court shall only direct that payment be made as such recovery is payable,  
( 45 whether by settlement, jury award, court award, or otherwise. "Marital share" means that  
( 46 part of the total personal injury or workers' compensation recovery attributable to lost  
( 47 wages [ : lost earning capacity ] [~~r and medical and hospital bills~~] accruing during the  
( 48 marriage and before the last separation of the parties, if at such time or thereafter at  
( 49 least one of the parties intended that the separation be permanent.

50 H. I. Nothing in this section shall be construed to prevent the affirmation, ratification  
51 and incorporation in a decree of an agreement between the parties pursuant to §§ 20-109  
52 and 20-109.1. Agreements, otherwise valid as contracts, entered into between spouses prior  
53 to the marriage shall be recognized and enforceable.

54 I. J. A court of proper jurisdiction under § 20-96 may exercise the powers conferred by

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1 this section after a court of a foreign jurisdiction has decreed a dissolution of a marriage  
2 or a divorce from the bond of matrimony, if (i) one of the parties was domiciled in this  
3 Commonwealth when the foreign proceedings were commenced, and (ii) the foreign court  
4 did not have personal jurisdiction over the party domiciled in the Commonwealth, and (iii)  
5 the proceeding is initiated within two years of receipt of notice of the foreign decree by  
6 the party domiciled in the Commonwealth, and (iv) the court obtains personal jurisdiction  
7 over the parties pursuant to § 8.01-328.1 A 9, or in any other manner permitted by law.

COMMENT #15(8 K. This act shall apply to all suits filed after July 1, 1990.

## Official Use By Clerks

## Passed By The Senate

without amendment ☐with amendment ☐substitute ☐substitute w/amdt ☐

## Passed By

## The House of Delegates

without amendment ☐with amendment ☐substitute ☐substitute w/amdt ☐

Date: \_\_\_\_\_

Date: \_\_\_\_\_

Clerk of the Senate

Clerk of the House of Delegates



## COMMENT #1

## P. 1, LL. 18-19: GENERAL CLASSIFICATION AUTHORITY.

This provision legislatively reverses the "unitary theory" of property classification established by the ruling in *Smoot v. Smoot*, 213 Va. 435, 357 S.E.2d 728 (1987). The problems created by this ruling, its impact on Virginia's extreme law of transmutation, and the implications of post-*Smoot* cases such as *Lambert*, *Ellington*, *Westbrook*, *Pommerenke* and *Lassen* are well-addressed in the Report on the issue rendered by the Legislative Subcommittee of the Board of Governors, Family Law Section, Virginia State Bar, dated September 29, 1989. The need for a legislative reversal of *Smoot*'s "unitary theory" of property classification is recognized by virtually all family law practitioners and judges who have reviewed the issue.

The language of this provision clearly provides the trial court with the authority to classify property as "part marital" or "part separate" in accordance with the "marital partnership" set forth in the new subdivision A(3) of § 20-107.3. The necessity for such specific language arises from the holding in *Smoot* that the existing statutory language "does not recognize a hybrid species of property."

In virtually all other common law equitable distribution states, statutes similar to the existing Virginia statutory language have been interpreted by case law to permit hybrid classification in order to fairly recognize "source of funds" credits or identifiable contributions by a spouse to the "marital partnership" that justify the inclusion or exclusion of "part" of property in the marital estate. Specific statutory language in many other states similarly permits hybrid classification of property to fairly recognize such contributions. However, it was the unexpected strict statutory interpretation by the Virginia supreme Court in *Smoot* that has caused Virginia to be virtually alone in preventing a "part" classification of property where fairness and well-recognized "source of funds" rules would otherwise have justified such a hybrid classification. Thus, the Virginia ruling in *Smoot* that "property must be classified as either all marital or all separate, not both" is specifically reversed by this legislative language, making Virginia's equitable distribution law as to property classification consistent with the "marital partnership: theories well-recognized by virtually all other common law states.

## EXAMPLE 1

Husband owns a certificate of deposit in his sole name in the sum of \$10,000.00 at the time of his marriage. Wife owns a CD in her sole name in the sum of \$20,000.00 at the time of the marriage. After the marriage, the parties combine the funds into a single jointly owned CD in the face amount of \$30,000.00, which is in existence at the time of the separation of the parties. Assuming that the contributions are retraceable in accordance with the evidentiary standards set forth in subdivision A(3)(d) or (e), the trial court shall classify the \$30,000.00 CD as Husband's part separate property "to the extent" of \$10,000.00, and Wife's separate property to the extent of \$20,000.00.

*EXAMPLE 2*

Assume same facts as Example 1, except that Husband's \$10,000.00 CD is deposited into a joint savings account after marriage which contains \$20,000.00 from the wage incomes of both parties during the marriage. Assuming the Husband's contribution of his CD is retraceable in accordance with the evidentiary standard set forth in subdivision A(3)(d) or (e), the trial court shall classify the joint savings account as Husband's part separate property to the extent of \$10,000.00, and the \$20,000.00 balance of the account would be classified as marital property. The ultimate division of the marital part of the savings account, being the sum of \$20,000.00, would be divided by the court between the parties after its consideration of the § 20-107.3(E) factors.

*ANALYSIS OF EXAMPLES 1 AND 2:*

Under present Virginia law as expressed in *Smoot*, the \$30,000.00 CD in Example 1, or the \$30,000.00 joint savings account in Example 2 would be classified as entirely marital property, with the separate CD contributions of each party being transmuted by their commingling. The ultimate division of the entire CD or savings account would be in the total discretion of the trial court, which could consider, among other factors, the source of acquisition of the funds pursuant to § 20-107.3(E)(6). However, post-*Smoot* cases have made it clear that the statute does not mandate such a division, leaving trial courts, practitioners and clients without any guidance or reasonable expectations as to the ultimate division of the property. The authority of the trial court to make a hybrid classification is permitted by the legislation to address this problem.

*COMMENT #2**P. 1, LL. 33-34: DEFINITION OF SEPARATE PROPERTY.*

This language clarifies that the definition of separate property includes that hybrid "part" of property under subdivision A(3) which is classified as "part separate" property.

*COMMENT #3**P. 1, LL. 34-36: INCOME FROM SEPARATE PROPERTY.*

The present statutory language defines *all* income received from separate property as separate property. Similar seemingly unambiguous language relating to the "increase in value" of separate property was held, however, in the *Lambert* and *Ellington* cases to permit the transmutation of the *entire value* of the formerly separate property to marital property where the increase or appreciation in value was due to the *active* (but not passive) *efforts* of either party.

This amendment and language is an attempt to address two problems with the existing statutory language. First, it avoids the potential of a similar harsh result of transmutation that occurred in the *Lambert* and *Ellington*

cases. The Court of Appeals, based upon this present case law, could predictably hold that the *active efforts* of either party in generating *income* from separate property would similarly result in the transmutation of the entire value of such property into marital property.

Second, the amendment reflects a fairer result to the marital estate by including income as marital property, but only to the extent it is generated from the *active personal efforts* of either party during the marriage. Passive income would remain separate property. The inclusion of income generated from *active marital effort* would be consistent with the marital partnership theory.

The net result of the language is to preserve or keep intact the integrity of the separate property itself as separate property, but to include in the marital estate that income, *but only the income itself*, generated from the *active personal effort* of either party. Passive income not resulting from marital effort, and therefore not affecting the marital relationship or partnership of the parties, would remain separate property.

#### EXAMPLE 3: INCOME-PASSIVE

Wife owns a rental home in her sole name at the time of her marriage to Husband. Prior to and after the marriage, the rental income received from the property is kept in a separate bank account in Wife's sole name, and all expenses relating to the property, including taxes, insurance and mortgage debt are paid directly from said account. The property is managed by a real estate management company and neither party performs any activities such as repairs, debt payments, or rent collection relating to the property. There is \$3,000.00 in said rental account at the time of the parties separation. Since this income was not attributable to the personal efforts of either party, the \$3,000.00 account would be the separate property of Wife.

#### EXAMPLE 4: INCOME-PERSONAL EFFORTS

Assume the same facts as Example 3, except that the Wife, during the marriage collects the rent, makes arrangements for the repairs to the real estate, negotiates the lease agreements, and does the accounting work relating to payments for said property. Under these circumstances, the real estate itself would remain classified as the separate property of Wife (subject to the rules on "increase in value" during the marriage contained in subdivision A(3)(a)), and the income in the account at the time of the parties separation would be classified as marital property. The \$3,000.00 in the said account would thereafter be divided by the court between the parties based upon the factors set forth in § 20-107.3(E).

#### EXAMPLE 5: INCOME-PASSIVE

Husband owns a certificate of deposit in the sum of \$20,000.00 at the time of his marriage to Wife. All interest checks received from said certificates are deposited in a checking account in Husband's sole name. At the time of the separation of the parties, the account has \$4,000.00, all representing the interest income from said CD's. The funds in this checking account would be

classified as Husband's separate property since they resulted from passive income.

#### EXAMPLE 6: INCOME-COMMINGLING

Assume the same facts as in Example 5, except that the interest checks are deposited in the joint checking account of both Husband and Wife, and are commingled with the wage and other incomes of the parties. At the time of the parties separation, the balance in the joint checking account is \$10,000.00, and the account had not been reduced below the \$4,000.00 deposit balance during the marriage. Under these circumstances, pursuant to subdivision A(3)(d), the separate interest income, once commingled with the marital wages, would be transmuted to marital property. However, to the extent the account balance is retraceable to the interest deposits under the evidentiary standard set forth in subdivision A(3)(d), the account balance would be classified as part separate property, but *only to the extent* of such contributed property using standard "source of fund" rules. Thus, assuming traceability, the balance of the account would be classified as \$4,000.00 as the separate property of Husband, and \$6,000.00 as marital property. The marital property balance of \$6,000.00 would be divided pursuant to the consideration by the court of § 20-107.3(E) factors.

#### ANALYSIS OF EXAMPLES 3, 4, 5 AND 6:

The examples above reflect the application of the marital partnership theory to the issue of income generated from separate property during the marriage. In Example 3, the income is generated solely from the effort of others and not either party. In such a situation, no public policy justifies including this income in the marital estate and, therefore, such income would remain separate property. This assumes the income is maintained as separate property and would be further subject to the commingling and tracing rules set forth in subdivision A(3)(d) and (e) if such income is commingled with other marital property.

However, where the income is generated through the effort of a party during their marriage, which effort is made by a spouse, this affects the day-to-day functions and relationships of the parties and, pursuant to the marital partnership theory, should be included in the marital estate in order to reflect such marital effort. However, the inclusion will only be to the extent of such income generated from such effort, and the classification of the separate property itself would remain separate, subject to the "increase in value" rules set forth in subdivision A(3)(a). Such is the case in Example 4 applying the rule to a rental income situation.

Examples 5 and 6 show the application of the amendment to more classic passive income increases. Where stock dividends are generated, interest on CD's, the interest from mutual funds, bonds and other intangibles result merely from the investment return itself, no public policy justifies the inclusion of such income into the marital estate. This income, provided it is maintained separately, would remain separate property, as shown by Example 5. However, if the same interest income was commingled into other accounts of the parties,

which more commonly occurs in the real world relationship of married parties, the identity of the commingled interest is addressed by the subdivision A(3)(d) or (e) relating to commingled property. Subject to adequate tracing, and the use of the proceeds of such joint accounts as shown in Example 6, which rules are well-developed in other equitable distribution states, such interest income could still be classified as separate property, but only to the extent of such contributions. The commingling rules are more fully addressed in the comments to subdivision (A)(3)(d) and (e), Comments #11 and #12.

#### COMMENT #4

##### *P. 1, LL. 36-42: INCREASE IN VALUE OF SEPARATE PROPERTY.*

This language is in specific response to the harsh transmutation rulings of the *Lambert* and *Ellington* cases in which the Court of Appeals held that where the appreciation in value of separate property (i.e., a solely titled stock corporation owned by a spouse at the time of the marriage) is the result of the "active" efforts of the parties during the marriage, the commingling of this increase transmutes "the entire" property to marital property. The criticism of such rulings is well-set forth in the Report issued by this Subcommittee, dated September 9, 1989, and is a critical reason why virtually all family law practitioners and judges believe a legislative response to the entire transmutation area is needed in Virginia. The language also includes specific evidentiary standards as to when the personal effort of either party will permit the inclusion of the increase in value of an asset in the marital estate. The proposed standard is taken from the Illinois legislative response to similar transmutation problems experienced in their state, which standards have apparently satisfactorily resolved the issue in more recent Illinois cases studied by our Subcommittee. The intent and application of the legislative standard is more specifically set forth in the attachments to the Report of this Subcommittee, including the application of such standard in Illinois by the drafters of said legislation.

The net result of this statutory language is, first, to prevent the *total* transmutation of the *entire* asset into marital property based upon the active appreciation thereof by either party during the marriage. By the amendment permitting a hybrid classification of property, the integrity of the value of the property at the time of the marriage or its later commingling would be preserved, but the "increase in value" of such asset, during the marriage and only to that extent, would be classified as marital property to the extent the increase in value is attributable to such contributions.

Second, in the case of the personal efforts of either party, the specific standard to justify the inclusion of the extent of such increase in value into the marital estate requires the efforts to be "significant" and result in "substantial appreciation of the separate property." This language specifically responds to the lack of such standards in Virginia case law, and recognizes that minimal efforts (i.e., the "painting of a fence," "planting of a bush" at the business of the other spouse) would not justify the transmutation or inclusion of the business or asset into the marital estate.

Third, the language recognizes the significant personal effort or contributions of *either* party. It is the Subcommittees belief that where the day-to-day relationship of the parties affects their marital relationship and marital estate, such as the classic case of a full-time working husband in his previously separately owned business, and the non-working housewife, that the effort of *either* party in increasing the value of an asset such as a business, should be recognized in the marital estate. Thus, to the extent *only* of such increase in value by *either party*, where the effort is "significant" (the Illinois legislative standard), the marital partnership theory justifies the inclusion of that part of the increase of value reflecting such effort, as part of the marital estate.

**EXAMPLE 7: INCREASE IN VALUE-PASSIVE**

Husband owns 100 stock certificates titled in his sole name in XYZ Corporation valued at \$40.00 per share, or \$4,000.00, at the time of his marriage to Wife. The certificates remain in his sole name during the marriage, and all dividend income is automatically rolled over by the corporation to purchase additional shares of stock. There is a stock split of said stock during the marriage. At the time of the separation of the parties, Husband owns 450 shares of stock of said corporation, each share being worth \$52.00, or a total value of \$23,400.00. Since the increase in value is passive, and not the result of significant personal effort, the entire value of stock would be Husband's separate property.

**EXAMPLE 8: INCREASE IN VALUE-ACTIVE**

Same facts as Example 7, except Husband spends a minimum of 8 hours per week in working on his stock investments, and as a result of his expertise in the ability to buy and sell his stock, the value of the stock at the time of the parties separation is \$75,000.00. Wife has mailed envelopes containing stock certificate exchanges for Husband, and has occasionally taken telephone messages for Husband relating to investment information. The original \$4,000.00 value of stock would be Husband's separate property. That increase in value which would have resulted from passive increase would be Husband's separate property, being an additional amount of \$19,400.00 (\$23,400.00 passive increase—\$4,000.00 value at the time of the marriage). The active increase due to the personal effort of Husband would be marital property, being the sum of \$51,600.00 (\$75,000.00 value—\$23,400.00 passive increase/original value). This sum of \$51,600.00 would be divided between the parties based upon a consideration of the § 20-107.3(E) factors.

**ANALYSIS OF EXAMPLES 7 AND 8:**

Based upon these facts, the personal effort of Wife would assumingly be insignificant and not, by themselves, be a commingling or effort to justify inclusion of the increase in value as part of the marital estate. Whether such efforts would have justified such an inclusion under the present Virginia law expressed in the *Lambert* and *Ellington* cases is uncertain, but because of the possibility of such transmutation by these types of actions, the language clarifies this standard. More significantly, however, subdivision (A)(3)(a) would

include the increase in value of the property, to the extent of such increase only, if resulting from the significant effort of *either* party. Thus, in this Example, the active effort of Husband itself by his personal effort which affects his marital relationship by his expending of 8 hours per week, would justify the inclusion of the *extent* of such increase in value during the marriage. This would assume such efforts themselves result in substantial appreciation, in excess of that which would have resulted from mere passive appreciation had no active personal effort been expended by either spouse. Assuming the court found Husband's efforts to be significant, and the evidence further showed that Husband's efforts resulted in a substantial increase in value above and beyond that of what mere passive appreciation would have resulted, then the "extent" of such increase would be in the marital estate. This results in a fair apportionment of the increase of value of the asset reflecting the marital partnership theory, but *only* to the extent such efforts result in an economic affect of the marital relationship.

#### EXAMPLE 9: INCREASE IN VALUE-PERSONAL EFFORT

Husband owns 100% stock in his solely owned business, which business is worth \$200,000.00 at the time of his marriage to Wife. Wife is a homemaker, not employed during the marriage, but rendering non-money contributions to the family, while Husband works at this business during normal working hours. The business is the main source of income to the family during the marriage. After a 20 year marriage, the parties separate and the business is then worth \$450,000.00. Assuming the personal efforts of Husband (being "either party") under the proposed definition of separate property and as contained in subdivision A(3)(a), have been the main cause of the increase of value of the business during the marriage, and that his efforts have been significant, the trial court could classify the business as follows: The amount of \$200,000.00 of the business would be the Husband's separate property, being property representing the value at the time of the marriage. The "extent" of the increase in value *during the marriage*, attributable to such efforts of "either party" being the Husband in this case, would enable the trial court to classify the \$250,000.00 increase in value as marital property. The ultimate division of the \$250,000.00 marital part of the business would, however, still be in the discretion of the trial court pursuant to the actors set forth in § 20-107.3(E), and would not necessarily be an equal of 50/50 division, in accordance with the law expressed in the *Papuchis* and *Pommerenke* cases. Such division, accordingly, of the marital share of the \$250,000.00 would reflect the court's evaluation of the contributions of each party in each case during the marriage pursuant to the 107.3(E) factors.

#### ANALYSIS OF EXAMPLE 9:

The rationale for recognizing the personal efforts of "either party" under the analysis above is a recognition of the marital partnership theory. The courts should recognize the increase in value of an asset, such as a business, where it results from the day-to-day contributions of *either* spouse during the marriage which affect their marital relationship. Where the Husband actively

works at this business during his marriage, this affects the marital relationship no less than the non-owning spouse's contributions to the family. Thus, where those efforts are significant and result in substantial appreciation of the business (I.e., active efforts as opposed to passive appreciation not reflecting significant marital effort), the marital estate should be inclusive of such increase, *but only to the extent* such increase occurred *during the marriage*. The value owned by Husband at the time of the marriage, not being a reflection of any marital contributions, should remain intact as the separate property of the Husband. At present, the case law of Virginia expressed in *Lambert* and *Ellington* would render the *entire* value of the business as marital property.

The net result of the statutory language is consistent with the most non-Virginia case law on the subject by fairly apportioning the increase in value of an asset to reflect that part of the value which results from the significant marital effort of either party, but to similarly keep intact and to preserve the separate part of the value of such asset which *does not* reflect such contributions. More significantly, the language further protects the interest of a non-working homemaker who does not perform personal effort directly towards such business or asset, but whose day-to-day marital relationship with her spouse is affected by the other spouse's significant time and ability to work at such business to increase its value and provide income to the family unit. Such increase in value, by reflecting the efforts of "either party," more fairly compensates the marital estate. The language further clarifies, however, that insignificant efforts of either party, such as the "planting of a shrub" or "painting the fence" types of contributions does *not* render an asset as part marital where *neither* spouse made significant efforts towards such asset. Finally, the specific standard set forth in the language of "significant" efforts resulting in "substantial appreciation" of property (which language was taken from the Illinois legislation which similarly responded to their transmutation problems), provides the guidance and standards for such transmutation that are clearly lacking as a result of the Virginia case decisions such as *Lambert* and *Ellington*.

#### EXAMPLE 10: INCREASE IN VALUE-DISCHARGE OF DEBT

Husband purchases a \$50,000.00 home just prior to marriage with \$10,000.00 of separate funds as a down payment and a \$40,000.00 mortgage. All mortgage payments are made with marital funds, being the wages of either or both parties during the marriage. At the time of trial, the house is valued at \$80,000.00, and the principal mortgage balance is \$20,000.00, creating an equity of \$60,000.00. The separate estate of Husband has contributed \$10,000.00 to the equity in the home. The marital estate has contributed \$20,000.00. Thus, the separate and marital estates have a 1/3 and 2/3 interest in the home, respectively. The increase in value reflecting the contributions of the "marital" contributions under the proposed language would be 2/3 of the equity, or the sum of \$40,000.00 (2/3 of \$60,000.00 equity). The court would classify the Husband's 1/3 interest in the property as Husband's separate property, or the sum of \$20,000.00 (1/3 of \$60,000.00 equity).



*ANALYSIS OF EXAMPLE 10:*

The legislative language addresses other types of marital contributions, other than personal efforts, that result in the increase in value of assets. The use of marital assets to pay for the maintenance of separate property, to pay for the discharge of mortgage indebtedness or to pay for improvements to separate property are addressed by this language. It reflects the fair reimbursement to the marital estate where actual money or other more tangible contributions are made by either party, during the marriage, which affect their marital economic relationship, and which affect the "increase in value" of an asset.

Example 10 is an application of these fair rules to the classic example of a pre-marital home owned by one party where marital contributions, such as wages or other marital income, is used to pay the mortgage and thus increase its value. The "proportionate approach" to the contributions of separate and marital properties appears to be a fair method to permit a hybrid classification by the court, recognizing the proportionate contributions of each type of property, and a similar apportionment of the increase of equity of the home over the years of marriage. This method and proposed rule has been adopted in the case decisions of numerous other states, and is more specifically analyzed by the authors of similar Illinois legislation in the attachments to the Report of this Subcommittee dated September 29, 1989.

*EXAMPLE 11: INCREASE IN VALUE-IMPROVEMENTS*

The parties use \$10,000.00 of their joint bank account to add a room addition to the separately owned residence owned by Husband at the time of the marriage, and titled in his sole name. At the time of the trial, the home has appreciated to a value of \$100,000.00 without any liens, and 20% is attributable to the room addition as established by expert testimony. Under the "value added" rules for such improvements followed by most states, the court would classify 80% of the home's value, or the sum of \$60,000.00, as Husband's separate property, while the 20% of the equity or \$20,000.00 representing the enhancement of value caused by the marital contribution, would be marital property and divided between the parties in accordance with § 20-107.3(E).

*ANALYSIS OF EXAMPLE 11:*

Where the increase in value of a separate asset is due to the contribution of marital assets, under existing Virginia law, it can be assumed such commingling of marital funds into separate property would transmute the entire separate asset to marital property. The statutory language, permitting hybrid classification, more properly permits the court to classify part of the asset as marital property to the extent it increases in value due to such marital contributions. The general rule in most states in the case of improvements to property is the "value added" or the "enhancement in value" rule. Such a rule is consistent with the marital partnership theory by permitting the court to classify as part marital property that part of the *separate* value of the separate property that increased due to the contributions from marital property.

The rule would further avoid the total transmutation rules that would result from such commingling of properties under current Virginia case law.

*COMMENT #5*

*P. 1, LL. 44-45: DEFINITION OF MARITAL PROPERTY.*

This language clarifies that the definition of marital property includes that hybrid "part" of property under subdivision A(3) which is classified as "part marital" property.

*COMMENT #6*

*P. 1, L. 54—P. 2, L. 1: DUTY OF COURT TO*

*MAKE HYBRID CLASSIFICATION.*

Subdivision A(3) makes it mandatory for a trial court to classify property in a hybrid manner in accordance with the rules set forth in subdivision A(3)(a) through (e). The language's mandate that the court "shall classify" attempts to respond to the need to avoid the total discretion on the classification level which has resulted from the opinion in *Smoot* and post-*Smoot* transmutation cases.

Subdivision A(3) is also an organized attempt to concisely place in one section of the Code the various types of fact situations and rules applicable to property classification which confront family law practitioners and courts, and to articulate fair standards therefore which are consistent with the marital partnership theory.

It should be made absolutely clear that the amended language is not an attempt to dictate the division of the "marital share" of such property pursuant to § 20-107.3(E), or to enact a 50P0D/presumption for such division. Rather, it is an attempt to provide articulated and uniform rules at the classification level to reverse the harsh consequences of the *Smoot* decision.

*COMMENT #7*

*P. 2, LL. 2-4: INCOME FROM SEPARATE PROPERTY.*

This language requires the classification of that part of income generated from separate property as marital property, but only to the extent it results from the personal effort of either party. For a more detailed analysis, see Comment #3 and Examples 3, 4, 5 and 6.

*COMMENT #8*

*P. 2, LL. 4-8: INCREASE IN VALUE OF SEPARATE PROPERTY.*

This language requires the classification of that part of the increase in value of separate property to the extent marital property, such as wages, marital income, and other tangible contributions, or the personal effort of *either* party, contribute to such increase. In the case of the personal effort of *either* party, the effort must be "significant" and result in "substantial

appreciation" of property. For a more detailed analysis, see Comment #4, and Examples 7, 8, 9 and 10.

#### COMMENT #9

##### *P. 2, LL. 9-10: PENSIONS, ETC.*

In 1989, § 20-107.3(G) was amended to provide for the awarding of a percentage of the "marital share" of a pension, said share having accrued from the date of marriage to the date of the parties last separation. In essence, subsection 107.3(G) permits a "hybrid" classification in the case of pensions or other deferred compensation plans by definition. This subdivision A(3)(b) merely clarifies for consistency that said marital share as defined in subsection 107.3(G) shall be classified as marital property by the court. The portion of such pension which arose prior to the marriage or after the last separation of the parties shall be classified as the separate property of the owner of such pension or plan. The division of the "marital share" portion of the pension or retirement plan shall be in the discretion of the trial court in accordance with § 20-107.3(E) factors and the extensive existing Virginia case law approving numerous deviations from a 50/50 division of such pension between the parties.

#### COMMENT #10

##### *P. 2, LL. 11-13: PERSONAL INJURY AWARDS.*

There have been no Virginia Court of Appeals cases on the issue of the proper classification of personal injury or workman's compensation awards. Circuit Court opinions have been in conflict as to whether such awards are all marital property, separate property, or a hybrid of both. Other issues resulting in much litigation in other states, and not presently addressed by present Virginia case law, is the affect of the deferral of personal injury settlement or liquidation of an award after the separation of the parties, or the equitable distribution trial, where the actual injury occurred during the marriage of the parties. *See, e.g., In re marriage of Fields*, 779 P.2d 1371 (Colo. Ct. App. 1989) (unliquidated personal injury claim arising during the marriage is marital property). *But see contra, Hurley v. Hurley*, 342 Pa. Super. 156, 492 A.2d 439 (1985).

The legislative subcommittee believes it is appropriate and necessary to clarify the future uncertainty of this area in order to provide workable guidelines for practitioners and trial courts which recognize the underlying purposes of the marital partnership theory.

Subdivision A(3)(c) requires the classification of the "marital share" of a personal injury or workman's compensation award in accordance with new proposed subsection 20-107.3(H). An analysis of the proposed rules relating to such awards is contained in Comment #14.

## COMMENT #11

*P. 2, LL. 14-19: COMMINGLING OF PROPERTY, LOSS OF IDENTITY OF CONTRIBUTED PROPERTY.*

One of the main criticisms of Virginia's present transmutation laws is the extreme effect of commingling of marital and separate property, resulting at the classification level of the entire asset being classified as marital, with the total discretion of the trial court to divide such asset as it sees fit considering the 107.3(E) factors. The failure to permit a hybrid classification, or a "source of funds" type of consideration has resulted most recently in the *Lassen v. Lassen* case in the total transmutation of an asset, without a real articulation of standards for division on remand.

Subdivision (A)(3)(d) is adopted from similar language adopted by Illinois in their statutory response to their similar harsh transmutation case law. The implementation of this standard is more specifically set forth in the attachments to the Report of this Subcommittee dated September 29, 1989.

Basically, subdivision (A)(3)(d) permits the transmutation of previously owned separate property where it is commingled with other marital property, resulting in the loss of identity of the contributed property. Such would be the case where previously liquidated separate cash, stocks or assets are commingled into a joint bank account of the parties, or the separate bank account of one party containing marital property such as wages or income generated from marital property. To this extent, it recognizes the effect of commingling expressed by Virginia case law, as most recently expressed in the *Lassen* case.

However, consistent with the "source of funds" theory, if such contributions are "retraceable" by a "preponderance of the evidence," and was not a gift, then such contributed property shall retain their original classification, such property *shall* be classified by the trial court as "part separate" property and "part marital" based upon the "source of funds" rules well-established by non-Virginia case law. *See also Rexrode v. Rexrode*, 1 Va. app. 385, 339 S.E.2d 544 (1986) implying the use of such retracing to determine proper classification of credit union account. The ability to permit such a hybrid classification resolves the classification level problems which, at the present time, provide practitioners and courts with little guidance. For a basic application of the commingling rules, see Examples 1, 2, 5 and 6 and the examples contained in the article prepared by the authors of the Illinois statute attached to the Report of this Subcommittee dated September 29, 1989.

## EXAMPLE 12

Let's analyze the proposed subsection in reference to the facts contained in the *Lassen* case. Husband received an inheritance prior to the marriage. Assume the value of said accounts at the time of his marriage was \$50,000.00, and were certificates of deposit in his sole name. During the marriage, Husband liquidates \$40,000.00 of the CD's and placed them in a bank account which was in his sole name, but which contained \$1,500.00 which was from his retirement payments. One week later after the deposit of said CD's in the

bank account, Husband writes checks for \$40,000.00 for the purchase of three investment stock accounts which were in Husband's sole name. The accounts are valued at \$60,000.00 at the time of the equitable distribution trial. The \$10,000.00 CD remaining in Husband's name would be his separate property. The \$60,000.00 in the investment stock accounts would be Husband's separate property. The proceeds in the marital bank account would be marital property.

#### *ANALYSIS OF EXAMPLE 12:*

Pursuant to subdivision (A)(3)(d), the placing of the proceeds of the CD into Husband's bank account results in the transmutation of said proceeds into marital property since it would result in the loss of identity of the specific cash represented by the CD's where the balance in the account at the time of the deposit would be \$41,500.00. The stock accounts would initially be classified as marital property pursuant to § 20-107.3(A)(3)(d). However, unlike *Lassen* and pursuant to the authority of the trial court to make a hybrid classification, assuming the proceeds which led to the purchase of the investment stock accounts are retraceable by the preponderance standard of evidence, *to that extent*, said accounts would be Husband's separate property. This is a classic "source of funds" case that the statute attempts to address.

#### *COMMENT #12*

##### *P. 2, LL. 20-24: COMMINGLING OF PROPERTY, LOSS OF IDENTITY OF BOTH PROPERTIES.*

This subdivision deals with the situation where two separate assets are combined into a newly created asset during the marriage. This would be the combination of tangible assets, such as the creation of a new ring from a pre-marital engagement ring and a post-marital ring into a new ring, as occurred in the *Price v. Price* decision. Under such circumstances, the new property would be initially classified as marital property.

Subdivision (e) would also apply where marital and separate intangible property is commingled, such as the commingling of separate cash accounts and marital bank accounts into the purchase of a new account or asset. This was the fact situation of the *Lassen* case. See Example 6 and 11 for the application of this rule.

#### *COMMENT #13*

##### *p. 2, LL. 26-29: DEFINITION OF "PERSONAL EFFORT".—*

This language defines in more specific terms those types of efforts which may constitute the "personal effort" of a party. It is basically an adoption of the standard set forth in the Uniform Marital Property Act and variations of same adopted by other common law equitable distribution states. Due to extensive litigation in other states as to what types of personal efforts can be considered in the context of the issue of the classification of the "increase in value" of an asset, usually being a business, the legislative subcommittee is of the opinion this definition comprehensively includes those types of efforts that should be considered by the trial court.

## COMMENT #14

*P. 3, LL. 40-49: PERSONAL INJURY/WORKMAN'S  
COMPENSATION AWARDS.*

Subsection 20.107.3(H) would provide needed standards for the classification and division of personal injury or workman's compensation awards. Parallel to the pension division subsection contained in § 20-107.3(G), the legislation permits deferral of the payment of any monetary award arising out of said asset, where the claim has not yet been tried, liquidated, settled or paid pursuant to such an award. This avoids the extensive litigation on the issue of the "speculative" nature of a personal injury claim where such a claim has not yet been liquidated at the time of the equitable distribution trial, which has occurred in other states.

Based upon the better reasoned case law and the recent trend of non-Virginia case opinions, the legislation sets forth a "hybrid" classification of such awards into two distinct parts. The first part is a reimbursement to the marital estate of the financial loss to the parties resulting from such an injury due to the loss of wages of the injured party. The second part of such an award is the medical losses, and pain and suffering portion or other intangible consequential damages, which would be the separate property of the injured spouse.

The "marital share" of such an award, consistent with the marital partnership theory and with § 20-107.3(G) relating to pensions, would include only such wage losses to the parties that accrued during the marriage and before the last separation of the parties. Thus, at the time of an equitable distribution trial, the actual monetary loss to the economic partnership of the parties during the marriage could be quantified and identified, even though a settlement or award had not been completed.

Also consistent with the pension rules for the delay in payment of a retirement award, the statute would further permit the deferral of the payment of a personal injury award until settlement or trial of the injury case where payment to the injured spouse has not occurred at the time of the equitable distribution award. Such a mechanism makes common sense where the economic loss to the marital partnership is known at the time of the equitable distribution trial, but the award has not yet been received by the injured spouse. Such a mechanism would clarify this issue in Virginia and would avoid the extensive litigation that has occurred in other states on such issues.

*EXAMPLE 13*

During the marriage, Husband is injured in an automobile accident. His specials include \$5,000.00 loss of wages, and there is no evidence of permanent injury affecting Husband's future earning capacity. During the marriage and prior to the separation of the parties, Husband settled the case for \$15,000.00, netting \$10,000.00 after his payment for attorney fees. The \$10,000.00 is deposited in a separate account in Husband's name. The wage loss portion of the claim is \$5,000.00, and \$10,000.00 is the remaining portion of the settlement, being 1/3 and 2/3 proportions. The net proceeds received after

payment of attorneys fees is \$10,000.00, which would be classified as 1/3 marital property, or the sum of \$3,333.33, and 2/3 the Husband's separate property, being the sum of \$6,666.67. The marital portion of said proceeds would be divided by the trial court pursuant to § 20-107.3(E) factors.

#### EXAMPLE 14

Same facts as Example 13, except that there has been no trial or settlement of the claim at the time of the equitable distribution trial. The trial court would classify as the "marital share" of the property the loss to the marital estate due to wage loss based upon the percentage of the overall settlement, and award a spouse a portion of such percentage at the time received by the injured spouse. The following formula could be used by the trial court in such circumstances:

$$\frac{\$5,000.00}{x} \quad (\text{marital share}) \quad \text{(total settlement amount)} \quad x \% \quad x \quad \begin{array}{l} \text{Net Settlement} \\ \text{proceeds received by} \\ \text{injured spouse.} \end{array}$$

For example, using the \$5,000.00 wage loss set forth above, if settlement was made 1 year after the equitable distribution trial, for the amount of \$25,000.00, and Husband's settlement netted \$16,666.67 after payment of attorneys fees, and unpaid medical bills, and further assuming the trial court determined the non-injured spouse should receive 30% of the "marital share," the net result would be an award to the Wife (non-injured spouse) of the sum of \$1,000.00 ( $\$5,000.00/\$25,000.00 \times .30 \times \$16,666.67$ ) and the remaining net settlement proceeds to the Husband (injured spouse).

#### COMMENT #15

##### *p. 4, LL. 8-9: EFFECTIVE DATE OF AMENDMENTS.*

This provision makes it absolutely clear that it is intended that this legislation applies only to divorce suits filed after July 1, 1990. It was inserted to clarify that these amendments, which are considered by the drafters of the legislation to be substantive in nature, do not apply retroactively to pending cases. Due to the significant substantive changes in the classification of property itself, the intent is to leave no doubt that the legislation is substantive and not procedural and therefore, applies prospectively only.

Such an approach is consistent with Virginia case law on the issue, and a similar result and analysis relating to pension classification contained in an opinion of the Attorney General to Delegate James F. Almand, dated August 23, 1988, relating to the 1988 legislative amendments to § 20-107.3.