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MEASURING ACTIVE AND PASSIVE APPRECIATION IN SEPARATE PROPERTY

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I. INTRODUCTION

One the most difficult issues in all of property division law is the classification of appreciation in separate property. The issue is difficult on two distinct levels. First, at a conceptual level, when the legislature decides that certain assets should be separate property, it necessarily intends that those assets should be separate property in the form in which they are usually found. Life is not stagnant, and most separate property increases in value slowly over time due to forces outside the control of the owner. If these increases are treated as marital property, then the courts are not properly respecting the legislature's determination that the underlying separate asset, in its normal and ordinary form, should be treated as separate property.

But not all increases in the value of separate property are outside the control of the owner. On the contrary, many increases in the value of separate property are deliberately created by marital efforts during the marriage. One of the strongest policies in all of equitable distribution is that the fruits of the parties' labors during the marriage must be treated as marital property. This policy is violated if increases in value of separate property are treated as separate property, *when those increases result from marital contributions*. Even worse, the owners of some types of assets, especially businesses, can easily convert income into appreciation simply by retaining that income in the business. In order to effectively enforce the rule that marital income is marital property, therefore, it is necessary in some situations to treat some appreciation in separate property as marital property.

Second, at a practical level, all separate property questions are made much harder by the fact that separate property is only rarely kept separate. Early in the history of equitable distribution, a few states experimented with holding that separate property becomes marital property if commingled with any marital property whatsoever. *See* 1 Brett R. Turner, *Equitable Distribution of Property* § 5:20 (3d ed. 2005 & Supp. 2009). This rule was an epic failure, for almost all separate property is commingled with at least some amount of marital property. To hold that commingling destroys separate property is to refuse to recognize most separate property at all, for almost all separate property is commingled. In the real world, to recognize separate property and

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exclude it from division, the law must openly confront the fact that marital and separate property are often mixed together.

The issue of classifying appreciation in separate property, therefore, is often hopelessly entangled with the issue of identifying the marital and separate components of commingled property. Before classifying appreciation in separate property, the court must first identify the marital and separate components in the base unappreciated value of the underlying asset.

Divorce Litigation last addressed the classification of appreciation in separate property in 2001. *See* Brett R. Turner, *Distinguishing Between Active and Passive Appreciation in Separate Property: A Suggested Approach*, 13 Divorce Litigation 73 (2001). This article is a comprehensive update, including all material in the prior article, plus an additional nine years of case law.

II. CLASSIFYING UNAPPRECIATED VALUE: APPRECIATION VS. ACQUISITION

The first step in classifying any appreciated separate property is to classify the base unappreciated value of the asset. When an asset comes from only one source—for example, when a business was acquired before the marriage or when a CD is traceable to an inheritance—this is a comparatively simple task.

The majority of all assets, however, are not traceable to a single separate source. Rather, the real value of most assets comes from a combination of marital and separate contributions. In this situation, most states measure the marital and separate contributions, and then use some form of allocation formula to compute the amounts of the marital and separate interests. The most common allocation formula expresses the marital interest as a percentage, equal to the total marital contributions, divided by the total of all contributions. The separate interest is likewise the separate contributions, divided by the total contributions. *See generally* 1 Turner, *supra*, § 5:25.

In applying allocation formulas, it is important to keep in mind the fundamental distinction between acquisition and appreciation. Most states define acquisition dynamically as the process of acquiring property. For example, when a home is purchased on credit, the home is not deemed to be 100% acquired as soon as the parties make the down payment. Rather, the home is acquired gradually as the parties reduce the balance on the mortgage. Stated differently, the parties acquire and own only the equity, not the entire asset. *Id.*

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This fact has important practical consequences upon classifying appreciation in separate property, for the same contribution cannot at the same time be treated as both a contribution to acquisition and a contribution to appreciation. The strong general rule is that contributions of marital funds to the purchase of an asset, or to the reduction of secured debt, are contributions to acquisition. *Id.* § 5:24 nn.4-8. These contributions are therefore considered when the court classifies the base unappreciated value of the asset, and not when the court classifies appreciation.

Two specific examples demonstrates the point. Assume that the husband owns 1000 shares of stock in a business at the time of marriage. During the marriage, the parties use marital funds to purchase another 1000 shares. Then the business doubles in value. The marital funds used to purchase the stock are not a contribution to the appreciation of the business. Rather, they are a contribution to the acquisition of 1000 additional shares. The classification of the appreciation in the separate shares depends upon the factors which caused the business to double in value, and not upon the marital contribution to the purchase of the second 1000 shares.

The same principle applies to nonbusiness assets. Assume that the husband makes a down payment on a home using $20,000 in separate property. The parties then use marital funds to reduce the value of the mortgage by another $20,000, and the home doubles in value. The marital mortgage payments are contributions to acquisition, not to appreciation. Since the marital and separate contributions are equal, the base value of the home is $40,000, of which 50% is marital and 50% is separate. The mortgage payments are not treated as a factor in classifying the appreciation. The classification of the appreciation—the doubling in value of the home during the marriage—then depends upon the factors which caused that growth, and not upon the mortgage payments. The mortgage payments did not increase the value of the home; they acquired additional marital equity. They are just like the marital funds used in the first example to acquire more stock in the business.

When an asset is traceable in part to contributions of marital funds, those marital funds are generally treated as a contribution to acquisition. The funds will therefore create a partial marital interest. All appreciation in marital property during the marriage, of course, is marital property. *See, e.g.*, *Dababnah v. Dababnah*, 207 W. Va. 585, 534 S.E.2d 781 (2000).

The first step in classifying appreciation is separate property is therefore to determine whether any partial marital interest exists. The amount of that interest, plus all appreciation in that interest, regardless of cause, is marital property. This amount is normally determined through use of an allocation formula.

This is not an article on allocation formulas, so many details and complexities have been omitted. For complete discussion of allocation formulas, see 1 Turner, *supra*, §§ 5:23–5:26.

III. GENERAL RULE

After accounting for any partial marital interest, plus any appreciation in that interest, we face the main subject of this article: classifying appreciation in separate property.

The general rule is simply stated. The classification of appreciation in separate property depends upon its cause. Appreciation which results from marital contributions, or *active appreciation*, is marital property. Appreciation which results from other causes, or *passive appreciation*, remains separate property.

For authority recognizing the distinction between active and passive appreciation, *see* Me. Rev. Stat. Ann. tit. 19A, § 953(2)(E); Fla. Stat. Ann. § 61.075(5)(a)(2); Ky. Rev. Stat. Ann. § 403.190(2)(e); Va. Code Ann. § 20-107.3(A)(3)(a); *Harrower v. Harrower*, 71 P.3d 854, 858 (Alaska 2003); *Layman v. Layman*, 292 Ark. 539, 731 S.W.2d 771 (1987); *Crapps v. Crapps*, 501 So. 2d 661 (Fla. Dist. Ct. App. 1987); *Halpern v. Halpern*, 256 Ga. 639, 352 S.E.2d 753 (1987); *McNaughton v. McNaughton*, 74 Md. App. 490, 538 A.2d 1193 (1988); *Nardini v. Nardini*, 414 N.W.2d 184 (Minn. 1987); *A&L, Inc. v. Grantham*, 747 So. 2d 832 (Miss. 1999); *Hoffmann v. Hoffmann*, 676 S.W.2d 817 (Mo. 1984); *Van Newkirk v. Van Newkirk*, 212 Neb. 730, 325 N.W.2d 832 (1982); *Scavone v. Scavone*, 230 N.J. Super. 482, 553 A.2d 885 (Ch. Div. 1988), *aff'd*, 243 N.J. Super. 134, 578 A.2d 1230 (App. Div. 1990); *Brennan v. Brennan*, 103 A.D.2d 48, 479 N.Y.S.2d 877 (1984); *Wade v. Wade*, 72 N.C. App. 372, 325 S.E.2d 260 (1985); *Walkup v. Walkup*, 31 Ohio App. 3d 248, 511 N.E.2d 119 (1986); *Templeton v. Templeton*, 656 P.2d 250 (Okla. 1982); *Murray v. Murray*, 312 S.C. 154, 439 S.E.2d 312 (Ct. App. 1993); *Mayhew v. Mayhew*, 197 W. Va. 290, 475 S.E.2d 382 (1996); and *Wierman v. Wierman*, 130 Wis. 2d 425, 387 N.W.2d 744 (1986).

IV. ELEMENTS AND BURDEN OF PROOF

To find that active appreciation exists, the court must make three lesser findings. First, it must find that the separate property at issue appreciated during the marriage by a certain specific amount. If there is no appreciation to begin with, there cannot be any active appreciation. *See Odom v. Odom*, 141 P.3d 324, 335 (Alaska 2006) ("[Alaska law] requires that the value of the asset have actually increased before the discussion may turn to whether that increase was due to active or passive forces."); *Reich v. Reich*, 652 So. 2d 1200 (Fla. Dist. Ct. App. 1995) (error to find active appreciation without first making a finding that property actually appreciated in value); *In re Marriage of Miller*, 231 Ill. App. 3d 480, 595 N.E.2d 1349 (1992) (noting that proof of capital expenditures by a business is not proof of resulting appreciation); *Palacci v. Palacci*, 613 A.2d 951 (Me. 1992) (where nonowning spouse did not prove appreciation, no active appreciation could exist); *Van Dyke v. Van Dyke*, 273 A.D.2d 589, 709 N.Y.S.2d 672 (2000) (husband's car dealership lost money or was barely profitable due to adverse market conditions; no appreciation); *Ciobanu v. Ciobanu*, 104 N.C. App. 461, 409 S.E.2d 749 (1991).

Second, the court must find that marital contributions were made to the appreciation. *E.g.*, *Odom v. Odom*, 141 P.3d 324, 338 (Alaska 2006) ("[T]he second finding made by the superior court, that no marital contributions were made to the partnerships, is sufficient on its own to counter the active appreciation argument.); *Schneider v. Schneider*, 824 S.W.2d 942 (Mo. Ct. App. 1992); *Fox v. Fox*, 294 A.D.2d 652, 742 N.Y.S.2d 411, 413 (2002) ["Where real property was unimproved,] defendant was entitled to a finding as a matter of law that any appreciation in the value of those parcels . . . was not due in any part to the efforts of either of the parties.").

Third, the court must find that the marital contributions caused all or part of the increase in value of the asset. *E.g.*, *Harrower v. Harrower*, 71 P.3d 854 (Alaska 2003); *Macaluso v. Macaluso*, 523 So. 2d 615 (Fla. Dist. Ct. App. 1988); *In re Marriage of Werries*, 247 Ill. App. 3d 639, 616 N.E.2d 1379 (1993); *Hartog v. Hartog*, 85 N.Y.2d 36, 647 N.E.2d 749, 623 N.Y.S.2d 537 (1995); *Wade v. Wade*, 72 N.C. App. 372, 325 S.E.2d 260 (1985).

Burden of Proof

The burden of proof is different for each of three elements. The burden of proving the first element, appreciation in value, is almost always on the nonowning spouse. If this were not the law, there would be a presumption that the entire value of separate property is appreciation, and therefore potentially marital property. That presumption would unduly weaken the concept of separate property. Almost all states agree that the nonowning spouse must prove the amount by which the separate property increased in value. *See Schmitz v. Schmitz*, 88 P.3d 1116 (Alaska 2004); *Robinson v. Robinson*, 10 So. 3d 196 (Fla. Dist. Ct. App. 2009) (error to hold that husband bore burden of proving date-of-marriage value of his premarital stock); *Warren v. Warren*, 866 A.2d 97, 103 (Me. 2005) ("The burden of establishing that the value of separate property increased during marriage is on the party asserting the increase."); *Fitzgerald v. Fitzgerald*, 914 So. 2d 193 (Miss. Ct. App. 2005); *Garfinkel v. Garfinkel*, 945 S.W.2d 744 (Tenn. Ct. App. 1996); *Smith v. Smith*, 439 Pa. Super. 283, 653 A.2d 1259 (1995); *Barnes v. Barnes*, 903 S.W.2d 211 (Mo. Ct. App. 1995); *Elman v. Elman*, 2002 UT App 83, 45 P.3d 176, 181. *But see Mayhew v. Mayhew*, 205 W. Va. 490, 519 S.E.2d 188 (1999).

To prove the amount of appreciation, the nonowning spouse must normally prove two things: the value of the asset at the time of marriage, and the value of the asset at the time of divorce. Most states require that the latter value be proven even if appreciation is not at issue. The main additional requirement, therefore, is the first one, the value of the asset on the date of marriage. *See Martin v. Martin*, 923 So. 2d 1236 (Fla. Dist. Ct. App. 2006) (without finding as to value of asset on the date of marriage, record contained insufficient proof of active appreciation); *Albanese v. Albanese*, 69 A.D.3d 1005, 892 N.Y.S.2d 631 (2010); *In re Marriage of Murphy*, 2010 OK CIV APP 1, 225 P.3d 820.

The burden of proving the second element, marital contributions, is also on the nonowning spouse. Once again, to presume that marital contributions are made to all separate assets would be to unduly weaken the concept of separate property. The legislature defined separate property as separate in recognition of the fact that it is not normally the product of marital contributions. The burden of proof should be placed on the party who seeks to establish the less common result. *See, e.g.*, *Harrower v. Harrower*, 71 P.3d 854, 859 (Alaska 2003); *Connealy v. Connealy*, 7 Neb. App. 117, 578 N.W.2d 912 (1998).

The definition of a marital contribution varies somewhat by state. A strong majority treats a marital contribution as a contribution by *either* spouse. *See Harrower v. Harrower*, 71 P.3d 854, 858 n.5 (Alaska 2003); *Webb v. Webb*, 636 So. 2d 883 (Fla. Dist. Ct. App. 1994); *Bass v. Bass*, 264 Ga. 506, 448 S.E.2d 366 (1994); *McNaughton v. McNaughton*, 74 Md. App. 490, 538 A.2d 1193 (1988); *In re Marriage of Morse*, 143 Ill. App. 3d 849, 493 N.E.2d 1088 (1986); *Goderwis v. Goderwis*, 780 S.W.2d 39 (Ky. 1989); *Hoffmann v. Hoffmann*, 676 S.W.2d 817 (Mo. 1984); *Wade v. Wade*, 72 N.C. App. 372, 325 S.E.2d 260 (1985); *Middendorf v. Middendorf*, 82 Ohio St. 3d 397, 696 N.E.2d 575 (1998); *Larman v. Larman*, 991 P.2d 536 (Okla. 1999); *Courembis v. Courembis*, 43 Va. App. 18, 595 S.E.2d 505 (2004).

A minority of states look only to contributions by the nonowning spouse. *See* N.Y. Dom. Rel. Law § 236B(1)(d)(3); *Smith v. Smith*, 9 Neb. App. 975, 623 N.W.2d 705 (2001); *Scavone v. Scavone*, 230 N.J. Super. 482, 553 A.2d 885 (Ch. Div. 1988), *aff'd*, 243 N.J. Super. 134, 578 A.2d 1230 (App. Div. 1990); *Mothershed v. Mothershed*, 1985 OK 23, 701 P.2d 405; *Jenkins v. Jenkins*, 345 S.C. 88, 545 S.E.2d 531 (Ct. App. 2001).

In states following the minority rule, when the nonowning spouse serves as a full-time homemaker, thus allowing the owning spouse to spend more time and energy managing separate property, the nonowning spouse may be indirectly responsible for any growth caused by the owning spouse. *See In re Marriage of Grady-Woods*, 577 N.W.2d 851 (Iowa Ct. App. 1998) (error to give homemaker wife no share of appreciation, where her contributions had contributed indirectly to husband's efforts); *Goderwis v. Goderwis*, 780 S.W.2d 39 (Ky. 1989); *Long v. Long*, 129 Md. App. 554, 743 A.2d 281 (2000); *Hanaway v. Hanaway*, 208 Mich. App. 278, 527 N.W.2d 792 (1995) (where husband's efforts managing company were facilitated by wife's homemaker services, appreciation was active); *Valentino v. Valentino*, 309 N.J. Super. 334, 707 A.2d 168 (App. Div. 1998); *Price v. Price*, 69 N.Y.2d 8, 503 N.E.2d 684, 511 N.Y.S.2d 219 (1986) (the leading case nationwide); *Brown v. Brown*, 913 S.W.2d 163 (Tenn. Ct. App. 1994) (wife's indirect homemaker services contributed to growth in husband's separate property); *Elman v. Elman*, 2002 UT App 83, 45 P.3d 176, 181; *Mayhew v. Mayhew*, 205 W. Va. 490, 519 S.E.2d 188 (1999).

But this theory works only if the owning spouse created appreciation. If the nonowning spouse is a homemaker, but the owning spouse creates no appreciation, there is no indirect marital contribution. *See Stoneman v. Drollinger*, 302 Mont. 107, 14 P.3d 12 (2000) (where husband did not improve or otherwise work on his premarital farm during the marriage, wife's contributions as a homemaker did not entitle her to any interest in the farm); *Chernoff v. Chernoff*, 31 A.D.3d 900, 821 N.Y.S.2d 276, 279 (2006) ("'[W]hen a nontitled spouse's claim to appreciation in the other spouse's separate property is predicated solely on the nontitled spouse's indirect [homemaker] contributions, some nexus between the titled spouse's active efforts and the appreciation in the separate asset is required.'") (quoting *Hartog v. Hartog*, 85 N.Y.2d 36, 647 N.E.2d 749, 623 N.Y.S.2d 537, 542 (1995))); *Fish v. Fish*, 161 A.D.2d 979, 557 N.Y.S.2d 549 (1990); *Keyt v. Keyt*, 244 S.W.3d 321, 329 n.10 (Tenn. 2007).

Case law is divided on the burden of proving the final element, causation. A majority of states hold that when separate property appreciated in value, and marital contributions were made, the burden is upon the owning spouse to prove that the marital contributions did not cause the appreciation. *See* Va. Code Ann. § 20-107.3(A)(3)(a); *Harrower v. Harrower*, 71 P.3d 854, 859 (Alaska 2003); *Yitzhari v. Yitzhari*, 906 So. 2d 1250, 1254 (Fla. Dist. Ct. App. 2005) ("Once it was established that marital labor or funds were used to improve these assets, the burden then shifted to the husband to show that some, if any, portion of the enhanced value was exempt from equitable distribution."); *Chapman v. Chapman*, 866 So. 2d 118 (Fla. Dist. Ct. App. 2004); *Allison v. Allison*, 246 S.W.3d 898 (Ky. Ct. App. 2008); *Warren v. Warren*, 866 A.2d 97 (Me. 2005); *Berenberg v. Berenberg*, 474 N.W.2d 843 (Minn. Ct. App. 1991); *Ciobanu v. Ciobanu*, 104 N.C. App. 461, 409 S.E.2d 749 (1991); *Volk v. Volk*, 2004-Ohio-1433, 2004 WL 573952 (Ct. App. 2004). *See generally* Joan M. Krauskopf, *Classifying Marital and Separate Property Combinations and Increase in Value of Separate Property*, 89 W. Va. L. Rev. 997 (1987) (strongly advocating this position).

The majority rule is justified by both theoretical and practical concerns. As a matter of theory, appreciation in separate property constitutes value acquired during the marriage. The general rule, of course, is that property acquired during the marriage is presumed to be marital property. This presumption is clearly already rebutted as to the base unappreciated value of separate property. But when marital contributions are present, and the amount of appreciation is proven, the presence of

the marital contributions suggests that the presumption has not been rebutted as to the appreciation. The burden is therefore on the owning spouse to prove that appreciation is not marital.

As a practical matter, the evidence needed to prove the causes of appreciation in separate property is almost always under the control of the owning spouse. If the burden of proving causation is on the nonowning spouse, the nonowning spouses faces difficult discovery issues in bringing the facts before the court. Conversely, if the burden of proof is on the owning spouse, the relevant factual material is much more likely to be produced. It is common sense to place the burden of proof upon the party who has best access to the relevant evidence.

A minority of states place the burden of proving causation upon the nonowning spouse. *See Waring v. Waring*, 747 So. 2d 252 (Miss. 1999); *Klaus v. Klaus*, 918 S.W.2d 407 (Mo. Ct. App. 1996); *Karas-Abraham v. Abraham*, 69 A.D.3d 428, 892 N.Y.S.2d 384 (2010); *Schwartz v. Schwartz*, 235 A.D.2d 468, 652 N.Y.S.2d 616 (1997); *Larman v. Larman*, 1999 OK 83, 991 P.2d 536; *Garfinkel v. Garfinkel*, 945 S.W.2d 744 (Tenn. Ct. App. 1996).

V. STANDARD OF CAUSATION

Very few decisions address in abstract terms the definition of causation for purposes of equitable distribution. Logically, however, the law of equitable distribution should adopt a definition of causation close to the tort-law concept of proximate cause.

A few decisions can be read to apply a standard of but-for causation. For example, in *Warren v. Warren*, 866 A.2d 97 (Me. 2005), the husband was a key employee but held only a minority interest in his employer. The trial court nevertheless held that the appreciation in his stock was active, and the appellate court affirmed:

> Claude expended substantial effort and labor during the marriage working in significant management positions for Bushmaster, and that Claude, being responsible for product design and manufacturing, played a key role in Bushmaster's success. On this basis, the referee concluded that the increase in value of Bushmaster stock was attributable to Claude's marital labor and therefore constituted marital property.
>
> Claude argues that the referee erred in treating the increase in value as marital property because he holds only a minority interest in the company and never influenced the financial direction of the company. The fact that Claude owned only a minority interest in the company is not significant. A key employee's efforts can increase a company's value. It is not necessary that the employee have control over the company's financial direction. Claude himself testified that he, with others, 'made the company what it is today' and that Bushmaster was his whole life.

Id. at 105.

Warren was on solid ground in holding that the husband caused substantial appreciation. But the holding that he caused *all* of the appreciation is deeply questionable, because the court admitted that other persons were active in the company, that the husband made important business decisions before the marriage, and that market forces were positive. The court explained its conclusion on this point as follows:

> Claude had the burden of proof, and the referee was not persuaded that any portion of

> the increase in value could be attributed to market forces alone. The evidence demonstrates that while Claude put the company's production systems in place prior to the marriage, he was in charge of manufacturing and operations during the marriage. While demand may have risen in response to external political forces, the referee did not clearly err in determining that such forces would not have affected the stock value without Claude's efforts.

Id.

The court's holding that the appreciation was active because it would not have occurred without the husband's efforts is unwise. Many people contribute to the success of any business enterprise, and the enterprise often would have failed to grow without the efforts of all of them. Nevertheless, it defies reality to suggest that all essential persons contribute equally to the success of an enterprise. A baseball team needs nine players, but some players contribute more to the success of the team than others.

The *Warren* court's holding is also contrary to the way in which the law normally understands causation. Maine held a century ago that a negligent act does not cause an injury merely because without the act, the injury would not have occurred. "[I]t is not enough that the negligent act complained of may constitute one of a series of antecedent events without which, as the result proves, the damage would not have happened." *Marsh v. Great N. Paper Co.*, 10 Me. 489, 64 A. 844, 850 (1906). Rather, if the injury was the result of "subsequent independent and efficient agencies, for which the defendant was not responsible," the defendant did not cause the injury, even if the injury would have occurred without the defendant's actions. 64 A. at 850.

The equitable distribution decisions nationwide have not discussed the theory of causation with the same depth as the negligence cases. Nevertheless, there is strong reason to hold in both settings that the law looks to *proximate* causation and not to but-for causation. But-for causation incorporates too many situations in which the relationship between events is fortuitous. For example, in cases like *Warren* in which the court must assess the role of premarital business decisions, the decisions will almost always be the but-for cause of growth during the marriage. But surely the marital interest should be greater if the success of the business depended upon decisions actually made during the marriage, as opposed to routine implementation of premarital decisions. A standard of but-for causation treats these two situations as identical, finding a 100% marital causation in each of them. This result is a major oversimplification of a complex world.

Another problem with but-for cause is that it leads to inconsistent results. In *Warren*, the court held that the husband caused all of the appreciation. If one of the husband's fellow owners is divorced next year, however, it is very possible that the court might hold that the other owner caused all of the appreciation, because the appreciation would also not have occurred without that owner's efforts. It is counterintuitive to assert that the appreciation is always disproportionately caused by the efforts of the owner whose divorce happens to be before the court. As this treatise has pointed out in countless other settings, unlimited expansion of the concept of marital property does *not* make the result more equitable; it makes the division process more unpredictable and expensive, and greatly reduces the chance for a negotiated settlement. The factors which cause the growth in a business should generally be the same, regardless of which of its owners is being divorced.

The better option is for the law of equitable distribution to follow the law of torts, and adopt the

concept of proximate cause. In *Warren*, as in many tort cases nationwide, an event did not cause an outcome merely because the outcome would not have occurred without the event. The issue was, in the language of the tort cases, whether market forces and the efforts of other owners were "independent and efficient agencies" in causing growth during the marriage. Likewise, the court needed to consider the extent to which the husband's actions during the marriage were an independent cause of corporate growth, separate and apart from the ordinary effect of decisions made before the marriage.

Whether a proximate cause analysis would have produced a different result in *Warren* is difficult to assess. If the husband failed to introduce sufficient evidence to determine realistically the role of nonmarital or premarital forces, the decision made was correct, for the burden of proof was properly on the husband. Future cases, however, should not accept the notion that a contribution causes growth merely because the growth would not have occurred without the contribution. Causation under the law of equitable distribution should have a different and more subtle meaning, one closer to the concept of proximate cause as used under the law of torts.

Another case which illustrates the distinction between but-for causation and proximate causation is *Brackney v. Brackney*, ___ N.C. App. ___, 682 S.E.2d 401, 409 (2009). *Brackney* arose in the context of appreciation in marital property after the date of classification, when the respective classifications of active and passive appreciation are the opposite of their classifications when separate property increases in value before the date of classification. *See generally* 2 Turner, *supra*, § 7:4. The parties in *Brackney* signed a contract to purchase a home. The contract required a $43,400 down payment, which was made with marital funds, but provided that the down payment would be forfeited if the parties failed to close. The divorce action was filed before closing, and the husband had to move the trial court for permission to close on the home to avoid forfeiture of the down payment.

After the husband's motion was granted, he then argued that the entire value of the home, including $181,000 in later passive appreciation, arose from his postseparation effort in filing the motion. It is completely true that without the husband's effort, the down payment would have been lost. But the effort necessary to file the motion was small compared even to the down payment, let alone the entire value of the home. The husband's effort may have been the but-for cause of the value of the home, but it was not the proximate cause. The court had little trouble holding that the home was divisible property.

VI. MARKET FORCES

The remainder of this article will assume that the majority rule applies, and that the owning spouse must prove that some or all of the appreciation in separate property was *not* caused by marital contributions. How can the owning spouse meet this burden?

To prove that appreciation was not caused by marital contributions, the owning spouse must generally prove that the appreciation *was* caused by factors other than marital contributions. In practice, there are two main factors other than marital efforts which tend to create appreciation: market forces and the efforts of third parties. By proving that one of these factors caused appreciation, the owning spouse necessarily proves that the same appreciation was not caused by marital contributions.

It is normally easiest to begin with market forces, because market forces can most easily be quantified. Market forces are normally measured by comparing the performance of the asset at issue with the performance of other, similar assets. For example,

when the asset involved is real estate, an expert can normally determine the extent to which real estate prices in the area have risen between the acquisition of the asset and the date of classification. That increase was a pure product of market forces, and it would presumably have occurred even if the owning spouse had not actively managed the property. Thus, it is clearly passive appreciation. *See Elmaleh v. Elmaleh*, 184 A.D.2d 544, 584 N.Y.S.2d 857 (1992) (appreciation in real property was passive where the real estate market in the area was generally rising during the marriage); *Barner v. Barner,* 716 So. 2d 795 (Fla. Dist. Ct. App. 1998); *Adkins v. Adkins*, 650 So. 2d 61 (Fla. Dist. Ct. App. 1994); *Zaretsky v. Zaretsky*, 66 A.D.3d 885, 888 N.Y.S.2d 84 (2009) (where commercial property appreciated "solely due to market forces," increase was entirely separate property); *Pauk v. Pauk,* 232 A.D.2d 386, 648 N.Y.S.2d 621 (1996).

Where real estate increased in value due to location or development value alone, it is possible that the appreciation might be passive even though marital contributions were made to the property. For example, in *Mitts v. Mitts*, 39 S.W.3d 142 (Tenn. Ct. App. 2000), the husband used marital efforts to build a golf course on the wife's separate property. But the property was ultimately sold for its development value. Since the presence of the golf course added nothing to the development value, the husband's efforts were not responsible for the increase in value, which was caused by market forces alone.

Likewise, when the asset involved is stock in a publicly traded company, it is possible to compute the percentage increase in the value of similar companies from the date of acquisition to the date of classification. That increase presumably results from market forces influencing the industry as a whole, and is therefore passive.

Measuring market forces is more difficult when the asset involved is an interest in a business which is not actively traded. An expert in the relevant field, however, can still attempt to determine the effect of market forces upon the value of similar companies. Even if market forces cannot be measured with precision, general testimony on the effect of market forces may be sufficient to account for all or part of the appreciation. *See Somps v. Somps*, 250 Cal. App. 2d 328, 58 Cal. Rptr. 304 (1967) (husband was civil engineer working on single-family homes in booming real estate market; appreciation mostly passive); *Tassi v. Tassi*, 160 Cal. App. 2d 680, 325 P.2d 872 (1958) (industry did well during marriage, and business had substantial sales volume from premarital customers; appreciation mostly passive).

Of course, where the economic data show that the relevant market forces were negative, and the business nevertheless grew in value, there is a strong likelihood that the growth was due to good management, not market forces. *See Haldemann v. Haldemann*, 145 Wis. 2d 296, 426 N.W.2d 107 (Ct. App. 1988) (where farm values were generally falling but the value of wife's farm was rising, appreciation was active); *Middendorf v. Middendorf*, 82 Ohio St. 3d 397, 696 N.E.2d 575, 579 (1998) (where husband's company prospered in "increasingly risky market," appreciation was active).

When comparable properties are used to measure passive appreciation, care must be used in selecting properties to compare. It is generally good to use the largest sample size possible, to make the conclusion more reliable. In particular, when a business is involved, it is important to use a sample which is representative of all companies in the field, not just those that are well or poorly managed. But it is also good to use properties which are as close as possible to the asset being classified. There is accordingly a degree of tension between the need for reliability (which favors a larger sample) and the

need for precision (which favors a narrower and therefore smaller sample). The difficulty in resolving this tension is one important reason why comparisons to other properties are best made by expert witnesses.

Nationwide or Regional Indices

Can market forces be measured with increases in general stock market indexes or other broad measures of economic growth in a country or region? A few cases accept evidence of regional or nationwide general market forces. *See In re Ney's Estate*, 212 Cal. App. 2d 891, 28 Cal. Rptr. 442 (1963) (appreciation in securities during the marriage was less than overall increase in Dow Jones index; appreciation was passive).

The problem with regional or nationwide indexes, however, is that they ordinarily include a very broad selection of different assets or businesses. For example, the general stock market increase of the 1990s and the general stock market decrease of 2000 and 2001 were disproportionately caused by the market's initial naive overvaluation and subsequent sober reassessment of the value of high-technology stocks. To use the Dow Jones index to measure passive appreciation in a traditional "bricks and mortar" company might well result in an inaccurate measurement. Conversely, to use the same index to measure passive appreciation in a high-technology company might be to commit the same error in the opposite direction.

Likewise, the stock market crash of 2008 and 2009 was triggered primarily by large-scale defaults on subprime mortgages. To use the Dow Jones index to measure passive appreciation in a company far removed from the subprime mortgages crisis might well be inaccurate.

As a general rule, the indicators used to measure market forces should be tailored as narrowly as possible to the specific characteristics of the asset at issue. Of course, there are limits on how specific an analyst can get; there will always be tension between the need for accurate data (requiring a narrower set of indicators) and the need for a reasonably sufficient sample size (requiring a broader set of indicators). The precise balancing of these factors in any case is a subject for expert testimony, filtered through the discretion of an experienced trial judge. It is safe to say, however, that where sample size is not an issue, the best indicators will be those most specifically related to the asset at issue.

Extraordinary Market Conditions

Individualized analysis is particularly important when the business in question was influenced by specific market forces unique to its type of asset or industry. Indeed, where such forces are present, it may be error to use a general market index at all.

Government Action. For example, in *Hoffmann v. Hoffmann*, 676 S.W.2d 817 (Mo. 1984), the husband ran a small company which manufactured water cooling towers. The company's performance was modest until the federal government passed the Clean Water Act of 1972. That legislation greatly increased the demand for cooling towers, and caused a substantial increase in the value of the company. The court held that the enactment of the Clean Water Act was a fortuitous circumstance well outside the control of either party. The appreciation was therefore passive, and it remained separate property.

Another classic government action which influences the value of property is the construction of a new public road. *See Harrison v. Harrison,* 912 S.W.2d 124 (Tenn. 1995) (interstate highway constructed across husband's separate property farm,

increasing value of farm dramatically; appreciation passive).

Appreciation caused by government action can be active where the owning spouse spent substantial time and effort successfully convincing the government to act. *See Innerbichler v. Innerbichler*, 132 Md. App. 207, 752 A.2d 291 (2000) (corporation's success depended upon valuable government certification, but husband had put considerable effort into applying for and receiving the certification; appreciation active); *Courembis v. Courembis*, 43 Va. App. 18, 595 S.E.2d 505 (2004) (husband received increased price for sale of separate property real estate parcel because property was favorably rezoned; wife's extensive lobbying efforts in support of the rezoning application were at least one significant factor in convincing the government to grant the application; appreciation active).

Government action which is merely a response to market forces may be essentially a facet of the market forces, and therefore not an independent source of appreciation when the market forces are only mildly favorable. "[A]n upswing in government outlays is simply a market expansion, and a business owner must still undertake significant efforts to benefit from such developments." *Hanson v. Hanson*, 125 P.3d 299, 305-06 (Alaska 2005).

Population Growth. In *Rowe v. Rowe*, 24 Va. App. 123, 480 S.E.2d 760 (1997), the husband owned a separate property newspaper located in Fredericksburg, Virginia. The population of the newspaper's circulation area increased dramatically during the marriage as Fredericksburg changed from an essentially independent town to a suburb of Washington, D.C. The expert witnesses all agreed that this population growth had played a major role in the growth of the newspaper. A trial court decision finding all of the appreciation to be active was reversed, and the case was remanded with instructions to find that a substantial portion of the appreciation was passive.

It should be noted that the business success of a newspaper is by nature heavily dependent upon the total population in its market area. Other types of business are not as population-dependent. For example, a corporation building parts for Ford automobiles would depend heavily upon demand from Ford, but would not depend very much at all upon fluctuations in the population of the town in which it is located. Population growth is an extraordinary market force only where local population is an important factor in determining the value of the business at issue.

Other Economic Indicators. When the performance of the business is heavily influenced by an economic indicator other than population, and the performance of the business matches the performance of the indicator, the appreciation is probably passive. *See Nordberg v. Nordberg,* 658 A.2d 217 (Me. 1995) (appreciation caused by fluctuations in international currency market was passive); *Myers v. Myers*, 70 Haw. 143, 764 P.2d 1237 (1988) (appreciation caused by favorable change in dollar/yen exchange ratio was passive).

Inflation

Can general nationwide changes in the value of money over time be treated as passive appreciation? There is respectable authority suggesting that inflation, and perhaps general fluctuations in the nationwide economy, should not be considered. In a case involving a small business, the Minnesota Supreme Court explained:

> There can be little doubt that more than 35 years of essentially prosperous and mildly inflationary economic conditions provided a

> favorable climate in which a budding business could grow and flower. But a business, like a flower, must be tended if it is to flourish. What [the husband] really invested in was the opportunity to turn his talents toward the development of an enterprise in which he had a personal stake.

Nardini v. Nardini, 414 N.W.2d 194, 194-95 (Minn. 1987); *accord Hanson v. Hanson*, 125 P.3d 299, 305-06 (Alaska 2005) ("[A]n upswing in government outlays is simply a market expansion, and a business owner must still undertake significant efforts to benefit from such developments."; appreciation not all passive); *Knowles v. Knowles*, 588 A.2d 315 (Me. 1991) (appreciation active despite technical advances in video field); *Abraham v. Abraham*, 230 La. 98, 87 So. 2d 735 (1956) (appreciation active despite generally prosperous times); *cf. Helen A.S. v. Werner R.S.*, 166 A.D.2d 515, 560 N.Y.S.2d 797, 799 (1990) ("[I]n distributing the property of a business in a matrimonial action, the focus should be on the evaluation and development of the business during the marriage and not on the isolated fact that it began prior to the marriage.").

A few cases nevertheless use inflation statistics to measure passive appreciation. *See Sommers v. Sommers,* 203 A.D.2d 975, 611 N.Y.S.2d 971 (1994); *Allen v. Allen*, 263 A.D.2d 691, 693 N.Y.S.2d 708 (1999). Apart from the *Nardini* issue of whether inflation can create value by itself, these cases suffer from the same flaw identified in the above discussion of broad nationwide economic indexes. The nationwide inflation rate is an average of rates in many different areas and industries, only one of which is at issue in any specific case. Assuming that inflation is to be considered, the best evidence would be tailored as narrowly as possible to the specific asset. For example, if the husband relies upon a 10% inflation rate in the United States during the marriage, but the wife points out that inflation in the specific industry of the husband's business was only 2%, the wife's figure seems more accurate. It might be proper to use the nationwide rate if there is no better evidence in the record, but when the evidence is conflicting, the local rate is likely to prevail.

It is also important to note that general inflation statistics may overlap with other measures of economic growth. To take one simple example, the Dow Jones index includes all increases in value of the stocks included, inflationary or otherwise. If an expert were to compute passive appreciation to include both the increase in the Dow Jones index and the increase in the consumer price index, inflation would be counted twice.

Note that it is error by any standard to hold that passive appreciation is *limited* to the amount of general inflation during the marriage. In *Calhoun v. Calhoun,* 331 S.C. 157, 501 S.E.2d 735 (Ct. App. 1998), *rev'd in part on other grounds*, 339 S.C. 96, 529 S.E.2d 14 (2000), the trial court treated only 2% inflation as passive appreciation. The appellate court reversed, noting that the parties had made no active contributions to the property, so that all of the appreciation was passive. The trial court erred by looking only to inflation, whereas passive appreciation properly includes all appreciation attributable to any type of market force, whether inflationary or otherwise.

VII. THIRD-PARTY EFFORTS

When the total amount of appreciation in separate property has been measured, and the appreciation caused by market forces has been excluded, what remains is the appreciation caused by good management of the asset at issue. If the asset was managed only by the owning spouse, that appreciation is probably entirely active. But many assets, especially businesses, are managed by

multiple persons. If the owning spouse can show that some of the appreciation was caused by the efforts of one or more of these persons, the same appreciation was not caused by the efforts of the parties.

To determine the extent to which third parties contributed to the growth of an asset, the court must consider a number of different factors.

Control During the Marriage

To begin with, the court must consider the extent to which either party had actual control over the value of the asset. When there was no such control, then all of the appreciation is normally passive.

Investors. For example, when a spouse purchases stock as an investment, and does not actually work for the company involved, the owner has no ability to control value, and there is usually no active appreciation. *See Doerr v. Doerr*, 751 So. 2d 154 (Fla. Dist. Ct. App. 2000) (stock); *Stefanowitz v. Stefanowitz*, 586 So. 2d 460 (Fla. Dist. Ct. App. 1991) (stock); *Franks v. Franks*, 759 So. 2d 1164 (Miss. 1999) (investment accounts); *Deffenbaugh v. Deffenbaugh,* 877 S.W.2d 186 (Mo. Ct. App. 1994) (mutual fund); *Baker v. Baker*, 753 N.W.2d 644 (Minn. 2008) (growth in investment stock is ordinarily passive); *Lee v. Lee*, 48 A.D.3d 377, 853 N.Y.S.2d 34, 35-36 (2008) (appreciation in Exxon and IBM stock was passive; "[T]he increase in the value of stock in these large, publicly traded corporations was due to market forces and inflation, not defendant's efforts."); *Goldman v. Goldman*, 248 A.D.2d 590, 670 N.Y.S.2d 521 (1998) (IRA); *Brown v. Brown*, 203 A.D.2d 912, 611 N.Y.S.2d 65 (1994) (investment account); *Shahidi v. Shahidi*, 129 A.D.2d 627, 514 N.Y.S.2d 259 (1987) (stock); *Barkley v. Barkley*, 119 Ohio App. 3d 155, 694 N.E.2d 989 (1997) (separate portion of savings plan); *Bakken v. Bakken*, 503 S.W.2d 315 (Tex. Civ. App. 1973) (mutual funds); *Huger v. Huger*, 16 Va. App. 785, 433 S.E.2d 255 (1993) (parties were minor shareholders without substantial control over company; appreciation was passive).

Directors and Officers. When the owner is a passive investor, the appreciation does not become active merely because the investor serves as a director or even officer. Some directors and officers contribute little to corporate management. "[A]n individual who is a board member, officer, and employee of a corporation controlled by his family, but who is not involved in the key functions of the business and only minorly involved in the business, does not contribute an effort to the corporation's income or appreciation." *Robert v. Zygmunt*, 652 N.W.2d 537, 544 (Minn. Ct. App. 2002). Of course, other directors and officers do contribute to corporate management and cause active appreciation. But the distinction depends upon the specific contributions made by the individual spouse. The mere title of director or officer is not alone sufficient to show that contributions were made.

Employees. Likewise, the mere fact that a spouse serves as an employee of a business is not alone sufficient to show that contributions were made or that appreciation resulted. Many business employees do not work at a high enough level to have meaningful control over corporate operations, and therefore do not contribute to corporate value. *See Schmitz v. Schmitz*, 88 P.3d 1116, 1127 (Alaska 2004) (husband "only performed some accounting and tax returns for the store and attended its annual meeting"; insufficient marital contributions even to reach the causation issue); *Porter v. Porter*, 67 Ariz. 273, 195 P.2d 132 (1948) (husband was low level employee who performed only ordinary duties for corporation; appreciation passive); *Lawson v. Lawson*, 288 A.D.2d 795, 732 N.Y.S.2d 753 (2001) (husband did minor booking services for company and discussed its welfare with his mother;

appreciation passive).

The cases have found that employees contributed little value even when they were regular employees with significant management responsibility, so long as they did not participate in the top management of the company. For example, in *Golub v. Ganz*, 22 A.D.3d 919, 802 N.Y.S.2d 526 (2005), the wife owned nonvoting preferred stock in her employer, a corporation run by her father and uncle. She was "but one of hundreds of midlevel managers amongst the corporation's 102 grocery stores and 22,000 employees and [had] specifically eschewed any career track which would ultimately place her in a high corporate position." 802 N.Y.S.2d at 529. The court held that the appreciation in her stock was entirely passive:

> Testimony specifically established that plaintiff, as a midlevel manager, has no role in corporate policy-making decisions, has no input into corporate procedures and is not even the manager of an income-producing department. Rather, she is in marketing. Nor has she ever been consulted by any member of corporate management or the board of directors regarding anything other than her specific duties. The record further satisfies us that none of the positions ever held by plaintiff, nor her attendance at corporate meetings or charitable events, has affected the profitability of the corporation.
>
> Rather, according to the corporation's senior vice president of finance and chief financial officer, only about 15 people in the corporate structure actually affect its profitability, including the corporation's president and chief executive officer, its senior management team and certain vice-presidents. Significantly, plaintiff has never held any of these positions. Nor has she ever served on the corporation's board of directors. In sum, while plaintiff readily admitted that she has attended a few board of directors meetings and certain charitable events in a personal capacity, we conclude that Supreme Court correctly found that defendant failed in his burden of demonstrating that the appreciation in her premarital shares of the corporation's stock was due in part to her contributions or efforts

Id. at 529-30; *see also Sexton v. Sexton*, 125 S.W.3d 258 (Ky. 2004) (husband's father formed real estate partnership to own apartment building and gave interest in it to husband alone; building increased in value solely because father worked long hours improving the condition of the apartment building; husband worked for partnership but had no significant control over its value; appreciation passive); *Godley v. Godley*, 110 N.C. App. 99, 429 S.E.2d 382 (1993) (husband owned stock in family corporation, but was middle level employee without control over company operations; appreciation was entirely passive); *Keyt v. Keyt*, 244 S.W.3d 321, 331-32 (Tenn. 2007) (husband worked regularly as employee of company, but he "had no permanent managerial authority," "did not oversee the delegation of authority to other employees," was not "involved in the hiring and firing of employees," and was not an officer, director, or division head; no substantial contribution to growth of company, and appreciation was entirely passive).

Top Management. At the opposite end of the corporate ladder, appreciation in the value of a business is frequently active when the owner is among the top managers of the company. This is especially true in a small business, where the extensive powers of a sole shareholder make classification as active hard to avoid. *See Marcum v. Marcum*, 779 S.W.2d 209 (Ky. 1989) (appreciation held active, relying mainly upon fact that business had been husband's primary occupation throughout the marriage); *Innerbichler*

v. Innerbichler, 132 Md. App. 207, 752 A.2d 291 (2000) (appreciation caused by dynamic husband who served as CEO and clearly controlled company was entirely active, even though he owned only 51% of the company, and 49% owner also worked there); *A&L, Inc. v. Grantham*, 747 So. 2d 832 (Miss. 1999) (appreciation in business run by husband during the marriage was substantially active); *Middendorf v. Middendorf*, 82 Ohio St. 3d 397, 696 N.E.2d 575 (1998) (where husband played "pivotal role" in success of small business, appreciation was active); *Haslem v. Haslem*, 133 Ohio App. 3d 257, 727 N.E.2d 928 (1999) (appreciation in husband's stationary business was active); *McLeod v. McLeod*, 74 N.C. App. 144, 327 S.E.2d 910 (1985) (appreciation held active, largely in reliance upon broad powers of shareholder and officer of close corporation); *Schorer v. Schorer*, 177 Wis. 2d 387, 501 N.W.2d 916 (Ct. App. 1993) (husband worked six to seven days per week as head of close corporation, and admitted his own success on cross-examination; appreciation held active).

Top executives can create considerable active appreciation even when the business is very large. For example, in *Berrie v. Berrie*, 252 N.J. Super. 635, 600 A.2d 512 (App. Div. 1991), the husband argued that the active appreciation theory cannot be applied to publicly held corporations. The court rejected this argument:

> Defendant further suggests that in no case can one person's effort be determinative of the value of a public corporation. We reject this thesis. There is no question that a single person's effort can influence the growth and success of a sole proprietorship, joint venture, partnership or a close corporation. As the organization grows, however, the question becomes one of fact, depending upon how closely the individual is identified with the business entity. The issue becomes intertwined with the valuation of the entity's goodwill, which is itself equitably distributable in an appropriate case. . . . For example, although a junior partner or shareholder in a law firm may share in the firm's goodwill, his or her presence or absence in the firm would not materially change the overall value of the goodwill. Yet, the goodwill of a law firm operated as a sole proprietorship with several associates may be completely dependent upon the firm's principal.
>
> This is true for a commercial corporation as well; and the fact that such a corporation is publicly held should not change the analysis. The efforts expended by the principal or even his or her mere presence may cause a willing buyer to pay more for the stock. While expert testimony most probably would be necessary to determine the effect of the individual upon the value of the stock, the fact that market forces might combine with such effect to control the price of the stock does not eliminate the factors relating to the individual. Expert analysis is admissible to show the effect the individual may have upon the value of a corporation.

600 A.2d at 516-17; *see also Berenberg v. Berenberg*, 474 N.W.2d 843 (Minn. Ct. App. 1991) (rejecting husband's argument that active appreciation cannot exist if the business has any shareholders other than the husband and the wife).

Perhaps the strongest factor in favor of the result in *Berrie*, not discussed by the court, is the salary structure of the corporate world. If top executives to large corporations contributed little, one would expect them to be paid little. But in fact, top executives in large corporations generally receive larger salaries than top executives in smaller corporations. This fact is considerable evidence that these executives earn their large salaries by making

significant contributions to corporate growth.

While active appreciation theory applies to large companies, it is generally true that large companies have more third-party managers, so that the percentage of value created by any one manager may be smaller. This is particularly true where the owning spouse is only one among several top managers. For example, in *Decker v. Decker,* 17 Va. App. 12, 435 S.E.2d 407 (1993), the husband was a high-level executive with a large, publicly held, textile company. Interestingly, he did not actually run the company until late in the marriage; for most of the time the parties were married, he was the company's top vice-president. His contributions to the company were nevertheless impressive:

> Apart from the non-monetary contributions of Mrs. Decker, as found by the commissioner, the record clearly demonstrates Mr. Decker's substantial contribution to the growth of PKC and the increase in value of its stock. While he was one of five key executives, his testimony described his position as "first among equals." The corporation apparently recognized his value by purchasing ten million dollars of insurance on his life, the same amount purchased on the life of the company president. No other corporate executive was insured for more than three million dollars. When allocating bonuses . . . , the corporation gave Mr. Decker a share equal to that received by the president. His value was further recognized by his dramatic rise on the corporate ladder. Ultimately, when the company needed a new president, Mr. Decker was selected for the job. He ran the day-to-day operations of the plant, was responsible for the finance division, and exercised a substantial amount of influence over the sales division.

435 S.E.2d at 411-12. Despite this evidence, the husband was only one of five top executives in the company, each of whom had made similar contributions to its overall growth in value. The court therefore held that only 20% of the appreciation was attributable to *the husband's* efforts.

Likewise, in *Rowe v. Rowe*, 24 Va. App. 123, 480 S.E.2d 760 (1997), the husband and his brother owned and operated a newspaper. They split the management duties relatively equally, with the brother focusing on the financial end and the husband focusing on the editorial end. In addition, the brother assumed a greater role later in the marriage, as the husband spent more time and effort on activities for a national association of newspapers. The court reversed a lower court decision treating all of the appreciation as marital property, and remanded the case with instructions to treat appreciation caused by the brother's efforts as separate property.

For additional cases holding that appreciation is partly passive where material contributions were made by third parties who served in top-tier management positions, see *Nace v. Nace*, 104 Ariz. 20, 448 P.2d 76 (1969) (appreciation passive; relying in part upon contributions of husband's partner in theater business); *Oxley v. Oxley*, 695 So. 2d 364 (Fla. Dist. Ct. App. 1997) (trust run by trustee, as advised by husband's father and brother; also a business run primarily by third parties); *In re Marriage of Eddy*, 210 Ill. App. 3d 450, 569 N.E.2d 174 (1991) (ranch run by hired third party); *Klaus v. Klaus*, 918 S.W.2d 407 (Mo. Ct. App. 1996) (business run by hired managers); *Tzanopoulos v. Tzanopoulos*, 18 A.D.3d 464, 795 N.Y.S.2d 254, 255 (2005) (growth in wife's separate real property was passive; "[T]he development of the property was carried out substantially by local agents hired by the defendant."); *Lawing v. Lawing*, 81 N.C. App. 159, 344 S.E.2d 100 (1986) (appreciation

caused by husband's partner was passive); *Herron v. Herron*, 2004-Ohio-5765, 2004 WL 2426307 (Ct. App. 2004) (where wife, her two siblings, and her mother all made roughly equal contributions to success of company, proper to treat 25% of appreciation as active); and *Doerr v. Doerr*, 189 Wis. 2d 112, 525 N.W.2d 745 (Ct. App. 1994) (appreciation in trust caused by investment expertise of husband's father).

Supervisory Contributions. Managers of all sorts create appreciation not only by their direct contributions to the company, but also by selecting and supervising employees who work under them. These supervisory contributions tend to grow more significant as the business gets larger. For example, in *Hamilton v. Hamilton*, 2002-Ohio-2417, 2002 WL 1009359 (Ct. App.), the court essentially attributed the actions of lower-level employees to the husband, who extensively supervised them.

> The evidence revealed that Skip did have employees like Mike Smith and Marty Bray, the company's vice-president and office manager, respectively, who had significant responsibilities at the company. But Skip was responsible for overseeing the work of these employees to whom he attributes the success of the company. Bray described Skip as a "hands-on CEO." Furthermore, while Skip may not have gained a controlling interest in the company until 1993, the evidence demonstrated that Skip has been heavily involved in running the company since the 1970s, and was a pivotal reason for the company's success.

2002 WL 1009359, at *8.

Likewise, in *Innerbichler v. Innerbichler*, 132 Md. App. 207, 752 A.2d 291 (2000), the husband was 51% owner and chief operating officer of a very successful corporation. The court held that all of the appreciation was active, even though the corporation had many other employees. In reaching this result, the court specifically refused to attach any weight to contributions made by the husband's co-founder, who owned the other 49% of the company, expressly finding that this person reported to the husband and worked under his supervision. The court observed:

> Although we acknowledge that it is rare for one person singularly to wear all hats in the operation of a complex, technical, multi-million dollar business enterprise such as TAMSCO, one person can function in a capacity critical to a company's growth and development. Here, the [trial] court was clearly satisfied from the evidence that appellant [husband] was the driving force in TAMSCO's huge financial growth.

752 A.2d at 305. By relying on the husband's "critical" status as the "driving force" behind the company, the court essentially attributed to him appreciation caused by lower-level employees who worked under his direction.

Perhaps the ultimate example of creating value by supervising others is *Herron v. Herron*, 2004-Ohio-5765, 2004 WL 2426307 (Ct. App.). There, the wife's mother ran a business, employing the wife and her two siblings as executives. The business prospered under the joint management of the three children, and the mother did not play an active role in day-to-day business decisions. She did make a specific and deliberate decision, however, to bring the three children into the business. Because the mother was less active than the children, the husband argued that the appreciation should be divided equally among the three children, so that 33.3% of it would be active. The trial court divided the appreciation equally among the mother and the children, so that only 25% of the appreciation was active, and the appellate court affirmed. The court

therefore held that the mother caused 25% of the appreciation by the simple act of retaining competent second-tier management (her three children) to operate the business.

A somewhat contrary result was reached in *Smith v. Winter*, 64 A.D.3d 1218, 883 N.Y.S.2d 412 (2009), which held that the husband caused only 10% of the appreciation in PNA, a separate property company. The remaining 90% was "attributable to those hired by [the husband] to run the company." 883 N.Y.S.2d at 413. Thus, the court mostly did not attribute to the husband the efforts of those he hired. The opinion does not discuss the facts in any detail. It is possible that the other managers were hired before the marriage, so that their selection would constitute premarital effort. They may also have operated substantially independent of the husband's supervision. The husband was CEO of PNA's parent company, which may tend to suggest that his day-to-day supervisory contribution was limited.

Second-Tier Management. When a small business is dominated by a single dynamic CEO, the cases tend to attribute most or all of the appreciation to the CEO. When a large business is managed by a committee, the cases tend to divide the appreciation among the committee members.

In addition, some cases have been willing to attribute appreciation to leading executives below the top management level. In *Ellis v. Ellis*, 235 A.D.2d 1002, 653 N.Y.S.2d 180 (1997), for example, the husband operated a small furniture company along with five of his siblings. The husband was in sales from 1979 to 1990, and then in management from 1990 to 1993. Since the husband had been in sales for most of the marriage, the court held that it was fair to use sales figures to determine the role of the husband's efforts in the success of the company. Because the husband was responsible for 20% of the company's total sales from 1983 to the date of trial, the court affirmed a lower court decision holding that 20% of the appreciation was active.

For additional cases holding that material value was created by someone below top management level, see *Efstathiou v. The Aspinquid, Inc.*, 956 A.2d 110, 121 (Me. 2008) (trial court properly found marital interest of $625,000 in real estate business with a nonmarital interest worth roughly $1 million; husband did not have "a substantial active role" in the business, but did have an active role in obtaining one particular business property, which he and wife then operated together); *Armstrong v. Armstrong*, 72 A.D.3d 1409, 900 N.Y.S.2d 476, 483 (2010) (affirming trial court decision finding 10% active appreciation, based upon contributions of spouse who served as company's chief financial officer; "The importance of defendant to the company's success was confirmed by various proof, including testimony of the company's chief executive officer."); *Congdon v. Congdon*, 40 Va. App. 255, 578 S.E.2d 833, 839 (2003) (where husband's "father, brother, and other key officers played more active managerial roles in the family business" than did husband, affirming trial court finding that only 10% of the appreciation in husband's stock was active); *Smith v. Smith*, 197 W. Va. 505, 475 S.E.2d 881 (1996) (where husband worked for company as vice president, error to treat all of the appreciation as passive; some portion of the appreciation was clearly caused by husband's efforts). *But cf. Warren v. Warren*, 866 A.2d 97 (Me. 2005) (unwisely holding that appreciation was caused entirely by spouse who was key employee but only minority owner, on grounds that appreciation would not have occurred if employee had not been present; criticized in part V of this article).

Upper vs. Middle Management. The line between middle managers, who generally do not create value, and second-tier upper managers, who generally do create at least some value, is obviously rather fuzzy.

There are a few key facts, however, which tend to shed light on where the line lies.

Managers are most likely to create value for a company when they make unique contributions to corporate operations. If a business earns a profit in a particular area, and a manager oversees that area without assistance or oversight, the manager has probably contributed to the value of the business.

Stated from the opposite direction, value is generally not created when a manager works under the oversight or supervision of someone else. This is fundamentally why most contribution to corporate value are made by the top level of corporate management. For example, in *Rowe v. Rowe*, 24 Va. App. 123, 480 S.E.2d 760 (1997), the court held that substantial appreciation was caused by the efforts of the husband and his brother, who served respectively as editor and business manager of a small newspaper. But the court did not go so far as to hold that appreciation was caused by the efforts of each individual editor or reporter. The editors and reporters all worked under the supervision of the husband, who was widely-recognized as a leading editor of smaller newspapers. Not only did the husband supervise them, but he also hired them, or in some cases hired the people who hired them. When a top-tier manager selects and supervises lower level employees, the manager is in a sense responsible for the employees' efforts and contributions.

For specific cases attributing to executives the contributions of persons under their control, *see Innerbichler v. Innerbichler*, 132 Md. App. 207, 752 A.2d 291 (2000) (husband owned only 51% of corporation employing many people, but husband's extraordinary expertise gave him effective control over company; all appreciation active); *Decker v. Decker,* 17 Va. App. 12, 435 S.E.2d 407 (1993) (husband caused 20% of appreciation in large textile company, employing literally thousands of persons).

The extent to which managers create value, therefore, depends upon the extent to which they make independent contributions, not overseen or supervised by others. In most businesses, the top managers oversee all operations, so that lesser managers do not really make independent contributions. But this is not universally true, for in some businesses lesser managers may have more authority, especially over distinct segments of corporate operations which are somewhat severable from the core of company's business. For example, the newspaper in *Rowe* also owned a radio station. The manager of the radio station probably had a greater opportunity to create independent value than any lesser manager at the newspaper, as the skills and interests of the husband lay primarily in newspaper management.

An important key to determining the value created by lesser managers, therefore, is determining the extent to which they made independent contributions, without extensive oversight from managers at a higher level. Those who work independently have a greater chance to create value than those who work under supervision.

Nonowning Spouse's Efforts. One general exception to the rule against consideration of efforts of those below top management is contributions by the nonowning spouse. Courts often consider those efforts as having some degree of influence upon the corporation's value. *E.g.*, *Wittig v. Wittig*, 258 A.D.2d 883, 685 N.Y.S.2d 342 (1999) (wife served husband's insurance agency as officer and board member, managed a marketing and sales center, and presented seminars; appreciation active).

The rule applies not only where the nonowning spouse is a formal corporate employee, but also where he or she simply informally assists the owning spouse in running the business. *See, e.g.*, *Rider v. Rider*, 141 A.D.2d 1004, 531 N.Y.S.2d 44 (1988) (appreciation held active; relying, among

other factors, upon wife's willingness to help husband get loans for his separate property business); *cf. Haldemann v. Haldemann*, 145 Wis. 2d 296, 426 N.W.2d 107 (Ct. App. 1988) (husband worked on wife's farm for no apparent consideration; court held appreciation active but suggested that husband's services might not matter if wife had informally hired him to work on the farm as her agent).

The contributions of a nonowning spouse are especially significant where the nonowning spouse received little or no salary. *See*, *e.g.*, *Capasso v. Capasso*, 129 A.D.2d 267, 517 N.Y.S.2d 952 (1987) (wife worked in husband's separate business, keeping records, consulting, and answering telephone; her involvement diminished as the marriage continued, but she still consulted with husband and still entertained business associates; appreciation was held active and wife was awarded 20% of it). In this situation, because of the unreasonably low salary, the parties have constructively contributed marital funds to the corporation by deliberately paying the nonowning spouse less than his or her services are worth. *See Rogers v. Rogers*, 90 N.C. App. 408, 368 S.E.2d 412 (1988) (unreasonably low compensation, if present, would have been a surreptitious contribution of marital funds to business).

Cases considering the efforts of the nonowning spouse cannot be reconciled with cases considering third-party efforts. In fact, the courts routinely dismiss contributions of third parties which are many times more significant than the very limited contributions made by the nonowning spouses in the above cases. No decision has yet been able to explain this clear variance in approach. The only possible explanation appears to be that the contributions of the nonowning spouse are special.

Control Before the Marriage

Control of a business or other asset creates active appreciation only when control is exercised during the marriage. When appreciation during the marriage is caused by control decisions made before the marriage, the appreciation remains separate property.

For example, in *Hanson v. Hanson*, 125 P.3d 299 (Alaska 2005), the Alaska Supreme Court faced a situation in which the husband made substantial contributions before the marriage to his separate property business. Remanding the case back to the trial court, the supreme court noted the need to distinguish between premarital and marital contributons:

> Although Hans may have created the foundation necessary for Shaman's growth prior to the marriage, it was his later efforts—including the seventy-to ninety-hour work weeks he testified to—that helped effectuate its substantial growth. While the superior court may, on remand, impute part of the growth to Hans's premarital efforts or other factors, it would be unreasonable to conclude that Shaman was able to thrive and expand without any effort or guidance from Hans. . . . . On remand the superior court should determine what portion of the increase in Shaman's value was caused by Hans's efforts during the marriage, distinguishing the effects of these efforts from any appreciation stemming from passive factors.

Id. at 305-06. The percentage of active appreciation in *Hanson* is probably quite substantial, as the husband worked 70-90 hour work weeks during the marriage, a contribution of considerable value. Nevertheless, the fact that premarital efforts established a foundation for the growth is also a factor to be considered, and the trial court on

remand may "impute part of the growth to Hans's premarital efforts." *Id.*

Control Over Acquisition: Stock Portfolios

Note, however, that the definition of control includes not only control over the asset itself, but also control over the decision to acquire it. The distinction is easily seen by looking at parties who spend substantial time and effort managing separate property securities portfolios. These spouses have little or no control over the activities of the companies in which they invest, but *great* control over basic decisions to buy and sell.

If that control is used to generate significant value, at least some of the appreciation is attributable to good management of the portfolio, and it is therefore active. *See Becker v. Becker*, 639 So. 2d 1082 (Fla. Dist. Ct. App. 1994) (appreciation in husband's profit-sharing plan was marital property where wife actively managed it during the marriage); *Caffrey v. Caffrey*, 2 A.D.3d 309, 770 N.Y.S.2d 33, 34 (2003) ("The [trial] court properly considered the appreciation in defendant's IRA account to be marital property since defendant actively managed the investments in the account."); *Cowles v. Stahmer*, 255 A.D.2d 103, 679 N.Y.S.2d 607 (1998) (awarding wife 25% of the appreciation in husband's actively managed separate property securities accounts); *Nolan v. Nolan*, 107 A.D.2d 190, 486 N.Y.S.2d 415 (1985) (appreciation was active where husband was not employed and spent all his time managing his separate property securities portfolio); *Fredel v. Fredel*, 531 So. 2d 981 (Fla. Dist. Ct. App. 1988) (appreciation in actively traded stock portfolio was held marital property); *see also Miceli v. Miceli*, 533 So. 2d 1171 (Fla. Dist. Ct. App. 1988) (where husband spent all his time managing his separate investments and parties lived off of wife's income, trial court erred by not awarding wife any part of the parties' property); *Hanna v. Hanna*, 2003-Ohio-1401, 2003 WL 1463720 (Ct. App.) ("[D]ue to the labor involved with monitoring and managing the accounts, as well as, the monetary contributions of marital funds, 'all income and appreciation on separate property . . . that occurred during the marriage' is marital [property]."); *In re Morton*, 99 Or. App. 146, 781 P.2d 869 (1989) (wife used her skills as a realtor to help husband buy real estate with his premarital property; wife was entitled to interest in appreciation).

In order for a spouse to have effective control over the decision to invest, the owner must actually buy and sell investments during the marriage. If there is no actual trading, the owner did not use his or her control over the account to create any appreciation. *See Steele v. Steele*, 945 So. 2d 601 (Fla. Dist. Ct. App. 2006) (husband nominally managed 401(k) plan, but made only a few investment decisions with minimal overall impact on value; appreciation passive); *Barth v. Barth*, 790 S.W.2d 246 (Mo. Ct. App. 1990) (where the composition of the wife's portfolio did not substantially change during the marriage, the husband's investment skill did not cause appreciation); *Warner v. Warner*, 807 A.2d 607 (Me. 2002) (husband spent an hour per week researching issues involving his stock portfolio, but did not trade based on the knowledge, instead reinvesting all dividends into the same stocks; "[t]he routine and rudimentary nature of the decision to enroll in a dividend reinvestment program does not constitute substantial or active management, particularly where there is no evidence as to the time, energy, and resources expended in conjunction with the decision"; finding of active appreciation reversed); *In re Marriage of Owens-Koenig*, 194 Or. App. 573, 95 P.3d 1152, 1157, *modified on reconsideration*, 195 Or. App. 734, 98 P.3d 1143 (2004) (error to treat appreciation in wife's separate retirement account as marital property, where neither spouse made investment decisions regarding

the account during the marriage); *see also Baker v. Baker*, 753 N.W.2d 644 (Minn. 2008) (reversing court of appeals' opinion holding that control alone is sufficient to create active appreciation).

Of course, investment expertise can create active appreciation only where the portfolio did better than the market as a whole. If the portfolio merely matched the general market increase, all of the appreciation is excluded when market forces are considered, so that good management did not cause any part of the increase. *Compare In re Estate of Adams*, 132 Cal. App. 2d 190, 282 P.2d 190 (1955) (substantial gain in excess of market average; appreciation active), *and Chapman v. Chapman*, 866 So. 2d 118 (Fla. Dist. Ct. App. 2004) (where husband's actively managed separate property stock portfolio outperformed market indexes for both stocks and bonds, appreciation in excess of market index was active), *with In re Ney's Estate*, 212 Cal. App. 2d 891, 28 Cal. Rptr. 442 (1963) (appreciation in securities during the marriage was less than overall increase in Dow Jones index; appreciation passive), *and Gilman v. Gilman*, 32 Va. App. 104, 526 S.E.2d 763 (2000) (mere fact that husband used some degree of intellectual skill to select certain real estate investments not sufficient to show active appreciation; no evidence that investments selected were unusually good, or that the return earned exceeded other no-effort investment options).

There has been some discussion in the cases as to the proper method for determining whether a portfolio outperformed the market. *Chapman* looked to the S&P 500, a general market index often used by investors as a general measure of market performance.

In *Mathers v. Brown*, 21 So. 3d 834, 838 (Fla. Dist. Ct. App. 2009), where the husband's investment portfolio contained many foreign stocks, the appellate court held that the trial court properly refused to use the S&P 500 as an index, and treated all of the appreciation as marital property. It seems highly likely that some of the appreciation was passive—foreign stocks are influenced by passive market forces no less than domestic stocks—but the problem is that the husband did not present evidence of an index better-tailored to the foreign stocks actually held by the account. The clear lesson is that there is no one magic index, and that the index used should generally match the composition of the account at issue.

A different approach was taken in *Colley v. Colley*, 2009-Ohio-6726, 2009 WL 4936382 (Ct. App.), where the trial court gave weight to a broker's testimony that "assets under its investment authority averaged an annual rate of return of 10.4 percent." 2009 WL 4936382, at *7. There was apparently no showing that the overall pool of assets managed by the broker were similar to the assets held in the accounts being classified, or that the pool of assets was large enough to constitute a reliable sample. Stressing the fact that no alternative calculation was presented, the appellate court affirmed the trial court's decision. Had the record contained an investment return figure based upon a general nationwide index, appropriately tailored to the account being classified, the index would have been more reliable than the pool of assets being managed by the broker.

A minority of courts have been very quick to find active appreciation based upon relatively minor acts of investment control. *See Sizemore v. Sizemore*, 767 So. 2d 545 (Fla. Dist. Ct. App. 2000) (both parties actively researched the stocks in which the husband's separate property stock fund would be invested; no evidence that stock selected appreciated more than the market average; unwisely holding that all growth was active appreciation); *Carman v. Carman*, 22 A.D.3d 1004, 802 N.Y.S.2d 558, 562 (2005) (growth was entirely active, where husband "used his financial planning and accounting expertise to manage that account, even if only a few

times a year, directly and actively contributing to the appreciation in value of that account"); *Caffrey v. Caffrey*, 2 A.D.3d 309, 770 N.Y.S.2d 33 (2003) (holding that appreciation in actively managed IRA was active, but failing to find that active management improved the rate of return); *Hayman v. Hayman*, 2003-Ohio-76, 2003 WL 103413 (Ct. App.) (all appreciation in actively managed IRA was marital property; again, no evidence that active management improved the rate of return). The better approach is not to assume that control automatically creates growth, and instead to look at whether specific investment decisions actually resulted in a rate of return greater than the return which could have been realized with minimal risk.

Many persons who actively manage a stock portfolio rely to a greater or lesser extent upon the advice of an investment professional. In these cases, investment caused by the efforts of the investment professional is clearly passive. *See Adkins v. Adkins*, 650 So. 2d 61 (Fla. Dist. Ct. App. 1994) (likewise holding that appreciation in investment fund remained separate; fund was managed by third-party broker); *Dave v. Steinmuller*, 157 Md. App. 653, 853 A.2d 826, *cert. denied*, 383 Md. 570, 861 A.2d 60 (2004) (appreciation in wife's separate investment portfolio was passive, where account was managed by brokerage firm; husband spent substantial time tracking portfolio, and had veto power over firm's decisions, but offered no proof of how much growth in value resulted from his efforts, as opposed to efforts of broker); *Baker v. Baker*, 753 N.W.2d 644, 653 (Minn. 2008) (reversing court of appeals' opinion charging husband directly with all efforts put forth by hired brokers; "only the financial and nonfinancial efforts of the spouses themselves are relevant to the assessment of marital effort" when determining active appreciation); *Robertson v. Robertson*, 186 A.D.2d 124, 588 N.Y.S.2d 43 (1992) (where appreciation resulted from the efforts of third-party investment advisor, appreciation was passive); *cf. Mathew v. Palmer*, 8 Neb. App. 128, 589 N.W.2d 343 (1999) (rejecting attorney-husband's argument that marital interest arose because of his assistance in prosecuting wife's personal injury claim; wife had hired counsel, husband had not been asked to help, and there was no evidence that his assistance was of any particular value).

When an investment portfolio is managed by both the owner and a broker, the hard question is determining who was responsible for the growth. A North Carolina decision identified several factors to be considered in making this determination:

> (1) the nature of the investment; (2) the extent to which the investment decisions are made *only* by the party or parties, made by the party or parties in consultation with their investment broker, or solely made by the investment broker; (3) the frequency of contact between the investment broker and the parties; (4) whether the parties routinely made investment decisions in accordance with the recommendation of the investment broker, and the frequency with which the spouses made investment decisions contrary to the advice of the investment broker; (5) whether the spouses conducted their own research and regularly monitored the investments in their accounts, or whether they primarily relied on information supplied by the investment broker; and (6) whether the decisions or other activities, if any, made solely by the parties directly contributed to the increased value of the investment account.

O'Brien v. O'Brien, 131 N.C. App. 411, 508 S.E.2d 300, 307 (1998). On the facts, the *O'Brien* court found that the parties had mechanically accepted their broker's recommendations, and made no independent investment decisions, so that the appreciation was caused by the broker and by

market forces, and not by active marital efforts.

In *Hedges v. Pitcher*, 942 A.2d 1217 (Me. 2008), the Maine Supreme Court suggested a somewhat different list of factors to be considered:

> [T]o determine whether a spouse played a substantial active role in managing investments, a court must consider, among other factors: (1) whether a spouse engaged in routine reinvestment or, instead, actively managed the asset, *id.*; (2) whether the actions of a spouse were nominal, inconsequential, or sporadic, *id.*; (3) whether a spouse invested substantial marital time and energy in managing the asset [citations omitted]; (4) whether a spouse had an occupation separate from managing that property [citations omitted] and (5) whether a spouse's knowledge of and involvement with the property is casual or in-depth.

Id. at 1225.

On the facts, the husband in *Hedges* tracked his portfolio and met with his broker quarterly, but did not usually direct investment decisions. The court held that these actions were not sufficient to create active appreciation:

> Passive actions, such as following stock performance online, responding to the necessary inquiries from a broker, and meeting several times a year with a broker to review a portfolio, simply do not constitute the kind of active involvement that the Legislature anticipated would contribute to the conversion of nonmarital increases in value to marital property. If they did, the only real way for a married individual to maintain a nonmarital stock portfolio would be through a blind trust. Such distance is not required by law.

Id.; *see also Baker v. Baker*, 753 N.W.2d 644, 652 (Minn. 2008) ("Dr. Baker's activity with respect to the accounts consisted of selecting and occasionally changing investment advisors; authorizing money managers to make discretionary decisions about the investments; retaining discretion to direct investments but exercising that discretion on only one occasion (to invest in a business with which his son was involved); and declining to withdraw from the funds although they were available as liquid assets."; appreciation passive).

The husband did upon occasion suggest investments to the broker, but the court found these suggestions insubstantial:

> We conclude that those minimal actions are insufficient to constitute a substantial active role in the management of his investments. Managing the investments was not his central or even secondary occupation, and his efforts with regard to those investments did not consume the sort of marital effort and energy that would render the increase in value a marital asset.

Hedges v. Pritcher, 942 A.2d 1217, 1225-26 (Me. 2008). Of course, the husband could not have created growth by suggesting investments to the broker if the broker rejected the suggestions. To th extent that the broker accepted the suggestions, the key question would seem to be whether the investments suggested by the husband fared better than the investments suggested by the broker. If so, the argument for active appreciation would be stronger. but *Hedges* acted as if the suggestions had either been rejected by the broker, or had fared no better than the rest of the portfolio.

Control Over Sale Price

When an asset is actually sold at some point

before the divorce, the court must consider not only the factors contributing to the theoretical value of the asset, but also the factors contributing to the sale price. If the efforts of one spouse convinced the buyer to pay more for the asset than it was objectively worth, the difference is attributable to that spouse's active bargaining and marketing effort.

For example, in *DuJack v. DuJack*, 221 A.D.2d 712, 632 N.Y.S.2d 895 (1995), the husband's separate property company was sold for an unusually high price. The husband held the sale negotiations, and the court was convinced that his negotiating skills played a substantial role in determining the final sale price. The court therefore held that 40% of the appreciation was active. *See also* Va. Code Ann. § 20-107.3(A)(3)(a) (statutory definition of marital efforts which includes "marketing activity"); *Courembis v. Courembis*, 43 Va. App. 18, 595 S.E.2d 505 (2004) (where real estate developer bargained to acquire 15 individual adjacent lots for favorable terms, then combined the lots and sold them as a single parcel for a significant profit, resulting appreciation was active).

Of course, the mere fact that a spouse conducted or negotiated the sale of a particular asset does not itself show that effective negotiation resulted in a more favorable price. To show active appreciation through negotiation, it is essential to prove that the negotiation improved the terms of sale beyond the terms which would have been obtained if no negotiating effort had been made. Absent such a showing, bargaining efforts created no value. *See Harrington v. Mendieta*, 927 So. 2d 96, 97 (Fla. Dist. Ct. App. 2006) (artwork left to wife by her deceased artist sister did not grow in value because of wife's marketing efforts; "[A]fter listening to the testimony of both parties and several art experts, . . . the trial court determined the appreciated value of the artwork was due to other factors."; determination affirmed as within the trial court's discretion); *Southerland v. Southerland*, 278 Ga. 188, 598 S.E.2d 442, 444 (2004) ("While Husband's participation in finding properties and negotiating sales prices was undisputed, no evidence was presented showing how his efforts contributed to the value of the property."); *Courembis v. Courembis*, 43 Va. App. 18, 595 S.E.2d 505 (2004) (wife did not create value by setting up and operating an auction of the husband's separate property; no allegation that wife's efforts improved the amounts which buyers bid for the property).

Use of Control

In addition to looking at the extent to which the parties *could* control the value of the asset involved, the court must also consider the extent to which they actually used that power. If the power existed only in theory, and not in actual fact, little or no appreciation was caused by good marital management.

In particular, some business owners are "absentee landlords" who generally leave the management of the business to hired employees. These owners had the opportunity to create value, but they failed to seize that opportunity. Thus, the appreciation was probably mostly passive. *See Gilmore v. Gilmore*, 45 Cal. 2d 142, 287 P.2d 769 (1955) (husband owned car dealership, but worked short hours and took long vacations; automobile industry did well during the marriage; appreciation mostly passive); *Harrold v. Harrold*, 43 Cal. 2d 77, 271 P.2d 489 (1954) (car dealership case similar to *Gilmore*); *Oxley v. Oxley*, 695 So. 2d 364 (Fla. Dist. Ct. App. 1997) (appreciation in business was entirely nonmarital, even though the husband was the chief executive officer; most of the real management work was done by third parties, and husband had medical problems which apparently limited his ability to manage the company); *In re Eddy*, 210 Ill. App. 3d 450, 569 N.E.2d 174 (1991) (where ranch was run by hired third party, appreciation was

passive); *Feldman v. Feldman*, 194 A.D.2d 207, 605 N.Y.S.2d 777 (1993) (appreciation in husband's rental property was passive; while husband owned property, he did not actively manage it during the marriage); *Fountain v. Fountain*, 148 N.C. App. 329, 559 S.E.2d 25, 31 (2002) ("[T]he evidence shows Piggly Wiggly was managed by the 25% owner and Plaintiff had no involvement in the operations of the business."; appreciation passive); *Wright v. Wright*, 2008 WI App 21, 307 Wis. 2d 156, 747 N.W.2d 690, 697 (no active appreciation, even though husband was substantial shareholder and ran board meetings, as growth in corporation was due to expertise of its leading executive, Weigel; "Charles was not involved in running the day-to-day operation of FRG, that Charles was not experienced in running a foundry, and that Charles delegated all authority to Weigel to run the company.").

An absentee landlord can create value even without direct contribution, if substantial time and effort were spent selecting competent subordinates. The best example, discussed previously in this article, is *Herron v. Herron*, 2004-Ohio-5765, 2004 WL 2426307 (Ct. App.), where the court attributed 25% of the appreciation to the wife's mother, whose only contribution was to retain compentent managers (her three children) to operate her business.

In determining the extent to which a spouse was an absentee landlord, the court must essentially evaluate the extent to which the spouse actually used his or her power of control. The best measure over the long term may be simply the amount of time spent dealing with the investment. *See Mayhew v. Mayhew*, 205 W. Va. 490, 519 S.E.2d 188 (1999) (husband worked at car dealership from 7 a.m. until 8 p.m. on weekdays, and on Saturdays until mid to late afternoon; error to find no active appreciation). Raw time will not always be accurate, as some spouses will make valuable contributions in limited time, and others will spend substantial time doing very little. But time provides at least a quick prima facie indication of whether an absentee landlord issue might exist.

Extraordinary Use. Just as lack of exercise can reduce the theoretical value of control, the presence of extraordinary expertise can multiply it. In some situations, a talented spouse with limited control over a business may have a disproportionate effect upon its value. In *Innerbichler v. Innerbichler*, 132 Md. App. 207, 752 A.2d 291 (2000), the husband was 51% owner and chief operating officer of a very successful corporation. The court held that all of the appreciation was active, even though the corporation had many other employees. In reaching this result, the court specifically refused to attach any weight to contributions made by the husband's cofounder, who owned the other 49% of the company, expressly finding that this person reported to the husband and worked under his supervision. The court observed:

> Although we acknowledge that it is rare for one person singularly to wear all hats in the operation of a complex, technical, multi-million dollar business enterprise such as TAMSCO, one person can function in a capacity critical to a company's growth and development. Here, the [trial] court was clearly satisfied from the evidence that appellant [husband] was the driving force in TAMSCO's huge financial growth.

752 A.2d at 305. Thus, because of the husband's extraordinary expertise, he exercised effectively complete control over the company, even though his actual ownership interest was only 51%.

Where a sole owner has both control and expertise, a substantial marital interest is often inevitable. *See, e.g.*, *Lester v. Lester*, 547 So. 2d 1241, 1242 (Fla. Dist. Ct. App. 1989) (appreciation

entirely active where husband "was a recognized genius in his field and was firmly engaged in actively running his [separate property] business" throughout the marriage).

Negative Use. Of course, the mere fact that a spouse actually used his or her ability to control an asset does not mean that the exercise of control necessarily created value. Common sense suggests that businesses regularly lose value because of unwise decisions made by their top managers. Specific evidence of bad business decisions always supports a larger share of passive appreciation. *See Wallach v. Wallach*, 204 A.D.2d 211, 612 N.Y.S.2d 33, 34 (1994) (where husband played "active, if limited," role in managing business and some of his decisions were "less than beneficial" to the company, proper to find that appreciation was passive); *Ayres v. Ayres*, 230 Wis. 2d 431, 602 N.W.2d 132 (Ct. App. 1999) (company started only one new product line while husband was president, and that line was not profitable; appreciation was mostly passive).

Quantifying Contributions

Is there a simple method of quantifying the extent to which good management resulted from marital efforts? Such a method is suggested by the Virginia decision in *Decker v. Decker*, 17 Va. App. 12, 435 S.E.2d 407 (1993). In that case, the husband was one of five top executives of a large textile company. Market forces were not a factor in the growth of the company; indeed, the evidence suggested that foreign competition was causing many textile companies to decline in value. Since the husband was one of five people in a position to affect policy, the commissioner held that one-fifth or 20% of the appreciation was caused by his efforts. This decision was affirmed by both the trial court and the appellate court. The *Decker* approach is easy to apply: The appreciation caused by each manager is equal to the total appreciation caused by good management, divided by the total number of managers.

It is important to understand, however, that the *Decker* approach is not a fixed rule. The wife in that case argued that the husband was the most important of the company's top five managers, so that his share of the appreciation was more than 20%. While this argument failed on the facts, the court's willingness to consider the facts shows that the argument succeeded on the law. If the court had found on the facts that the husband's contributions exceeded those of the other managers, it might well have found more than 20% of the appreciation to be active.

A somewhat more sophisticated variant of the *Decker* approach would allocate appreciation among top executives in proportion to some measure of their actual performance. Salary might be one reasonable figure to use, on the assumption that salary is a result of arm's-length bargaining over the value of the executive to the company. For instance, if the husband earned $400,000 per year, and the corporation's two other top executives earned $300,000 per year each, the husband's share of the appreciation would be four-tenths or 40%. One could also look to the amount of key-man life insurance acquired by the company on the life of its executives (the court relied in part upon this amount in *Decker*) or economic data regarding the performance of those areas of the company supervised by different executives. *See Ellis v. Ellis*, 235 A.D.2d 1002, 653 N.Y.S.2d 180 (1997) (where husband was responsible for 20% of the company's total sales from 1983 to the date of trial, 20% of the appreciation was active). None of these measures is ideal for every case; for example, if salaries resulted from politics between top executives and shareholders, and not from arm's-length bargaining, salary would not be a good basis for measuring contributions. In many situations,

however, there may exist some form of statistic which can be used to measure the overall contributions of different executives.

Still another approach is to find some measure of what the company's value would be in the absence of the efforts of either spouse. A very simple application of this approach is to ask whether the value of the asset would differ if it were managed by a third person of average competence. For example, in *Scavone v. Scavone*, 243 N.J. Super. 134, 578 A.2d 1230 (App. Div. 1990), the husband testified that the value of his stock exchange seat would be the same regardless of whether he used it himself or leased it to a third party. The court accordingly held that the appreciation in the value of the seat during the marriage was passive.

Another specific application of this approach is *Stewart v. Stewart*, 728 So. 2d 473 (La. Ct. App. 1998). There, a health problem forced the husband to remain away from work for a period of time. During that period, the income of the business did not drop. The court held that the husband's presence did not seem to influence the welfare of the company, and that the appreciation was accordingly passive.

It is important to take a long-term view when evaluating the effect of a spouse's absence, for in many situations a spouse's efforts can influence the value of a company months or even years after they were made. For example, assume that an executive works long hours planning a corporate reorganization. Immediately after the reorganization is implemented, the executive takes a well-earned, two-month vacation. During that period, the value of the company remains steady, as the beneficial effect of the reorganization is offset by the difficulty of implementing it. The implementation issues are eventually resolved, and the reorganization causes a substantial long-term increase in corporate value. In this situation, it would be inaccurate to focus unduly upon the fact that the company's value remained constant during the two-month vacation. The absence was not long enough to create substantial evidence of the husband's level of contribution to the company, particularly since his efforts were deliberately focused upon creation of long-term value.

In addition, there may be limits to the validity of any sort of replacement analysis. The premise of the method is that no active appreciation exists when the owner and his replacement perform identically, but the replacement might still create some value with his or her personal efforts. Active appreciation is value created by *all* marital efforts, not just extraordinary marital efforts. Also, the method assumes that the contributions of other employees were equal before and during the period of replacement, when in reality other employees might have contributed more to make up for the owning spouse's lack of contribution. Despite these problems, however, replacement analysis can still shed considerable light on the extent to which the value of an asset arose from a spouse's efforts.

VIII. Conclusion

The law of active and passive appreciation in separate property is stable and well-settled. Active appreciation is marital property; passive appreciation is separate property. Applying this basic distinction to the facts is a continual challenge, however, as there are many different types of appreciated separate property which can appreciate for many different underlying reasons. The next decade, like the previous one, is unlikely to see much change in the rule itself. But the law will continue to develop gradually, as an increasing number of fact situations are addressed by an increasing number of court decisions.