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The Partnership Ideal: The Development of Equitable Distribution in North Carolina

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THE PARTNERSHIP IDEAL: THE DEVELOPMENT OF EQUITABLE DISTRIBUTION IN NORTH CAROLINA

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When the North Carolina General Assembly enacted the Equitable Distribution of Marital Property Act in 1981, it adopted a system of property distribution based on partnership principles. Because the Act was unprecedented in North Carolina, the courts had no experience to cushion their introduction to equitable distribution. Thus, the courts initially faced confusion, resistance, and uncertainty in their interpretation of the Act. Passage of the Equitable Distribution Act and the courts' interpretation of that Act have created enormous changes in North Carolina domestic law in the past five years.

Professor Sharp analyzes these changes by discussing case law developments and statutory amendments since the Act's adoption. Professor Sharp identifies those areas in which the courts have clarified major principles that will govern future interpretations of the Act. Professor Sharp also identifies those areas in which the courts have been unclear or inconsistent. Professor Sharp concludes by suggesting solutions to the difficult problems the North Carolina courts have yet to face in their implementation of equitable distribution.

I. INTRODUCTION

In less than a decade the process of divorce in North Carolina, as in many other states, has undergone profound transformations. Here, as elsewhere, two developments have been largely responsible for these changes: elimination of traditional fault-based grounds for divorce in favor of a no-fault system, and passage of a statutory scheme for equitable distribution of property upon divorce.[1] The two developments are closely related. No-fault divorce, available as a practical matter in North Carolina only since 1979,[2] has had many positive

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1. *See* L. GOLDEN, EQUITABLE DISTRIBUTION OF PROPERTY § 1.02 (1983 & Supp. 1986); Freed & Walker, *Family Law in the Fifty States: An Overview*, 18 FAM. L.Q. 369 (1985).

2. The advent of no-fault divorce in North Carolina was a little-heralded event. This was due, in part, to the fact it came about in a rather strange fashion. Separation of the spouses for one year, N.C. GEN. STAT. § 50-6 (1984), had long been an apparent exception to the fault-based grounds for divorce that were simultaneously available under the former statute. Act of May 20, 1965, ch. 636, §§ 1-6, 1965 N.C. Sess. Laws 703, 704, *repealed in part by* Act of June 24, 1983, ch. 613, § 1, 1983 N.C. Sess. Laws 548. Judicial decisions, however, had consistently allowed pleas of recrimination as

effects, but it also appears to have been a major cause of the well-documented decline in the economic well being of dependent spouses and their children after divorce.[3] Particularly within a "title only" scheme for property distribution such as had existed in North Carolina, no-fault divorce threatened great distributional inequities because it eliminated what had been the only true source of bargaining power for a financially dependent spouse—the ability to preclude the other spouse from obtaining a divorce.

Thus, the introduction of no-fault divorce simultaneously aggravated and highlighted the already patent inequities of a dissolution process that recognized no tangible or intangible rights to property accumulated during the marriage for a nonowner spouse.[4] It thereby greatly exacerbated pressures for reform of that system.[5] The ultimate response to these forces in North Carolina, again following a pattern well established in other common-law jurisdictions, was passage of the Equitable Distribution of Marital Property Act, which became effective October 1, 1981.[6]

The ostensible similarity of these developments in North Carolina to the course of domestic law reform in other states, however, is misleading. Indeed, passage of equitable distribution in this state cannot, strictly speaking, be called a "reform" at all. To a degree that appears to have been unprecedented, North

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an affirmative defense to divorces sought on separation grounds. *See, e.g.*, Overby v. Overby, 272 N.C. 636, 158 S.E.2d 799 (1968); Byers v. Byers, 223 N.C. 85, 25 S.E.2d 466 (1943). True no-fault divorce became available only in 1979 when North Carolina General Statute § 50-6 was amended to provide specifically that "a divorce under this section shall not be barred to either party by any defense . . . or plea of recrimination." Act of May 30, 1979, ch. 709, § 1, 1979 N.C. Sess. Laws 775, 775 (codified at N.C. GEN. STAT. § 50-6 (Supp. 1984)). Thus, it was the abolition of an affirmative defense to divorce on an existing ground that brought a true no-fault option to North Carolina. The remaining fault grounds for divorce under § 50-5 were eliminated altogether in 1983. Act of June 24, 1983, ch. 613, 1983 N.C. Sess. Laws 548. Alimony, however, remains wholly fault based in North Carolina. *See* N.C. GEN. STAT. § 50-16.2 (1984).

3. *See* Sharp, *Divorce and the Third Party: Spousal Support, Private Agreements, and the State*, 59 N.C.L. REV. 819, 821 n.6 (1981). Several states have had similar experiences as a result of no-fault reforms. *See* R. EISLER, DISSOLUTION: NO-FAULT DIVORCE, MARRIAGE, AND THE FUTURE OF WOMEN 14-15 (1977) (discussing the relationship between no-fault divorce legislation and the economic decline of dependent spouses); Weitzman & Dixon, *The Alimony Myth: Does No-Fault Make a Difference?*, 14 FAM. L.Q. 141 (1980) (comparing post-divorce living standards of men and women); *No-Fault Divorce as "Economic Disaster" for Wives, Children*, U.S. NEWS & WORLD REP., Nov. 4, 1985, at 63 (discussing the decline in divorced women's standards of living, the decreasing alimony trend, and the present inadequacy of child support awards).

4. The by now infamous case of Leatherman v. Leatherman, 297 N.C. 618, 256 S.E.2d 793 (1979), continues to be cited as a major impetus for passage of North Carolina's Equitable Distribution Act. *See* White v. White, 312 N.C. 770, 774, 324 S.E.2d 829, 831 (1985). In effect, *Leatherman* held that there was no means or theory under which a wife of many years, who had raised several children and continued to work virtually as a partner in her husband's closely held corporation, could be awarded any portion of the enterprise, or any reimbursement for her contributions thereto. Because she was not entitled to alimony, she received the maximum that she could get under North Carolina law—her half of the marital home titled in the entireties. *Leatherman*, 297 N.C. at 626, 256 S.E.2d at 798.

5. It is likely that the 1981 defeat of the Equal Rights Amendment in North Carolina also contributed to passage of the Equitable Distribution Act.

6. The most salient features of the North Carolina Act are that it establishes a classification based system for the distribution of marital property, defines separate property with remarkable breadth, and directs that marital property be distributed in an equitable, but presumably equal, manner, in accord with 13 distributional factors. For a more detailed discussion of the Act, see Sharp, *Equitable Distribution of Property in North Carolina: A Preliminary Analysis*, 61 N.C.L. REV. 247 (1983).

Carolina had no actual distribution system to reform.[7] North Carolina courts were, quite literally, lacking in power to transfer real property, or any interest therein, upon divorce.[8] The significance of this fact cannot be overemphasized; there was nothing in the history or experience of the North Carolina legal system to cushion its abrupt introduction to equitable distribution principles, or even to the concept of "marital" property.[9] Substantively and procedurally, therefore, the divorce settlement process in this State has been rebuilt from the ground up, from 1981 to the present.[10]

After an initial period of confusion, resistance, and marked uncertainty,[11] judges, lawyers, and even parties have begun to settle into the new system. This is particularly true with certain procedural questions.[12] And although the process of analyzing and interpreting the new statute is by no means complete, broad outlines are nonetheless becoming clear. A rapidly growing body of case law, plus a number of significant amendments to the statute, have clarified major policies and principles that will govern the future interpretation and implementation of the statute. The results thus far are quite promising. In particular, the "partnership" concept of marriage embodied in the statute has extended long-overdue recognition to the invaluable contributions of homemaker spouses and

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7. For a comparison with the more evolutionary development of such principles in other states, see Chastain, Henry, & Woodside, *Determination of Property Rights Upon Divorce in South Carolina: An Exploration and Recommendation*, 33 S.C.L. REV. 227 (1981); Scheible, *Marital Property in Tennessee: An Evolution, Not a Revolution*, 15 MEMPHIS ST. U.L. REV. 475 (1985); Note, *Property Distribution Upon Dissolution of Marriage: Florida's Need for an Equitable Distribution Statute*, 8 NOVA L.J. 71 (1983).

8. North Carolina General Statute section 50-16.7(a) does provide for payment of alimony "by transfer of title or possession of personal property or any interest therein, or a security interest in or possession of real property." N.C. GEN. STAT. § 50-16.7(a) (1984). No distributional principles ever developed from this limited provision, however. *See also supra* note 4 (discussing some of the distributional problems that led to the passage of the Equitable Distribution Act).

9. The statute itself unintentionally symbolizes how totally foreign concepts such as marital or separate property were in this state by referring to them with quotation marks. *See* N.C. GEN. STAT. § 50-20(b)(1), (2) (Supp. 1985).

10. The first appellate decision on the new Act came only in 1983. *See* Myers v. Myers, 61 N.C. App. 748, 301 S.E.2d 522 (1983). Since that time, however, there have been about 60 appellate decisions dealing with the statute.

11. The inevitable constitutional attack on the statute—for vagueness and denial of due process—was rejected in an early appellate decision. *See* Ellis v. Ellis, 68 N.C. App. 634, 636, 315 S.E.2d 526, 527 (1984).

12. In some instances the statute itself created troublesome procedural questions. *See infra* text accompanying notes 306-10. In other instances, appellate decisions apparently have been necessary simply to make clear that the statute means what it says. *See, e.g.*, McIver v. McIver, 77 N.C. App. 232, 233, 334 S.E.2d 454, 455 (1985) (order for equitable distribution must be supported by a finding that an absolute divorce has been granted); Gebb v. Gebb, 77 N.C. App. 309, 317, 335 S.E.2d 221, 227 (1985) (court is without authority to distribute property when neither party to an alimony and child support action has requested it); McKenzie v. McKenzie, 75 N.C. App. 188, 189, 330 S.E.2d 270, 271 (1985) (order for equitable distribution can follow only a decree of absolute divorce, not divorce from bed and board). There have also been a surprising number of cases in which lower courts have been reversed for their failure to heed the directive of N.C. GEN. STAT. § 50-21 (1984), that equitable distribution actions must precede any final orders for alimony and child support. *See* Dorton v. Dorton, 77 N.C. App. 667, 677, 336 S.E.2d 415, 422 (1985); Talent v. Talent, 76 N.C. App. 545, 556, 334 S.E.2d 256, 263 (1985); McIntosh v. McIntosh, 74 N.C. App. 554, 556, 328 S.E.2d 600, 602 (1985); Capps v. Capps, 69 N.C. App. 755, 757, 318 S.E.2d 346, 348 (1984). In Phillips v. Phillips, 73 N.C. App. 68, 326 S.E.2d 57 (1985), the court of appeals also held, in no uncertain terms, that there is no right to a jury trial (which had occurred in the lower court) of equitable distribution issues under North Carolina law. *Id.* at 70, 326 S.E.2d at 59.

has helped to restore considerable balance to the processes of private bargaining.[13] Most significantly, the partnership concept has been instrumental in guiding courts to a restrained interpretation of the broad separate property provisions of the statute.

Not surprisingly, adjustment to this new system has not been entirely smooth. The statute itself is unusually detailed. Partially as a result, it is also confusing and vague at times and, in several critical aspects, internally inconsistent.[14] Courts have thus faced very difficult interpretative problems in all stages of the property division process.[15] Furthermore, the courts have dealt with these issues, it must be recalled, virtually without the benefit of any useful precedent or reliable legislative history. That the results have not always been optimal is to be expected. This Article will attempt to identify, and to suggest solutions to several of the more difficult problems that the courts have confronted thus far. It will also attempt to analyze and synthesize other major judicial and legislative developments that have arisen, or are likely to arise, in the law of equitable distribution in North Carolina.

II. THE PARTNERSHIP CONCEPT

The "partnership" concept of marriage has unquestionably been the guiding principle for interpretation of the Equitable Distribution Statute. The "very *raison d'etre* of the Act," as the North Carolina Court of Appeals explained, is to "alleviate the inequities caused by the title theory approach to the distribution of marital property."[16] From the outset, moreover, the court of appeals interpreted this strongly remedial goal to encompass the partnership ideal of marriage[17] and the corollary of "repayment of contribution."[18] The North Carolina Supreme Court, in its first decision interpreting the broad policies of the Act, agreed: equitable distribution "reflects the idea that marriage is a partnership enterprise to which both spouses make vital contributions."[19] In a later deci-

13. *See infra* notes 16-20 and accompanying text.

14. *See infra* text accompanying notes 162-74 (discussing the exchange provision).

15. For a discussion of the three stages of the property division process, see *infra* note 32 and accompanying text.

16. Mauser v. Mauser, 75 N.C. App. 115, 119, 330 S.E.2d 63, 65 (1985). Strictly speaking, of course, there was no "marital" property concept under the title theory. The point is nonetheless clear. In an earlier decision the court of appeals had also concluded that the statute must be "construed broadly, in light of the evils sought to be remedied and the objectives to be attained." Wade v. Wade, 72 N.C. App. 372, 379, 325 S.E.2d 260, 268 (1985); *see also* Talent v. Talent, 76 N.C. App. 545, 334 S.E.2d 256 (1985) (court must examine a broad variety of factors in determining amount of spousal contribution to marriage).

17. *See, e.g.*, Hinton v. Hinton, 70 N.C. App. 665, 668, 321 S.E.2d 161, 163 (1984) (statute enacted "in recognition of marriage as a partnership"); White v. White, 64 N.C. App. 432, 436, 308 S.E.2d 68, 71 (1983), *modified and aff'd*, 312 N.C. 770, 324 S.E.2d 829 (1985); *see also* Loeb v. Loeb, 72 N.C. App. 205, 209, 324 S.E.2d 33, 37 ("The Act reflects a nationwide trend towards recognizing marriage as a partnership, a shared enterprise . . . . "), *cert. denied*, 313 N.C. 508, 329 S.E.2d 393 (1985).

18. *See* Wade v. Wade, 72 N.C. App. 372, 379, 325 S.E.2d 260, 268 (1985); Hinton v. Hinton, 70 N.C. App. 665, 669, 321 S.E.2d 161, 163 (1984). For further discussion of the significance of this repayment of contribution concept, see *infra* text accompanying note 115.

19. White v. White, 312 N.C. 770, 775, 324 S.E.2d 829, 832 (1985). The Act had been in effect for nearly four years before the supreme court addressed it.

sion, the supreme court explained further that the partnership approach is basically an "economic contribution theory of equitable distribution" and that the "heart of the theory" is the presumption that both spouses contribute equally.[20]

The partnership model has, of course, an inherent appeal. The analogy between partnership and marriages has long been an established part of speech and thought. Particularly important for North Carolina is the fact the analogy also held out some promise of legal concepts and principles with which courts were already familiar. In many respects, however, the ease of the analogy belies both the complexity of, and the variations within, the partnership concept.

In its broadest and most simple form, the partnership ideal does stand for the proposition that property acquired by the single enterprise of the marital unit, to which both spouses often are presumed to contribute equally, should be equally shared when the unit is dissolved by divorce.[21] Partnership principles seek to compensate, and thus implicitly to promote, the kind of sharing, and at times altruistic behavior in spouses that is deemed essential for the preservation of marriage.[22] In particular, the concept creates a means for recognition of the contribution of the dependent spouse, who may have sacrificed his or her own career potential for the sake of the other or the marriage itself.[23] At one level then, the partnership ideal enunciates a public policy of promoting sharing behavior, and marriage as an institution, by recognizing the economic value of what has traditionally been considered the "non-economic" contributions of a homemaker-spouse.[24] It also seeks to ensure that each estate is compensated fairly for its investment in the marriage. The combination of these public policies, coupled with the clear remedial purposes of the statute, make the partnership ideal an eminently suitable "first principle" for interpretation of the new statute by the North Carolina courts.

Beyond these fairly general principles, however, it is clear that the partner-

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20. Smith v. Smith, 314 N.C. 80, 86-87, 331 S.E.2d 682, 686-87 (1985).

21. *See* Prager, *Sharing Principles and the Future of Marital Property Law*, 25 UCLA L. REV. 1, 16-19 (1977). It should be noted, however, that not all common-law states have adopted a presumption that spousal contributions are equal. *See* Sharp, *supra* note 6, at 250; Comment, *The Development of Sharing Principles in Common Law Marital Property States*, 28 UCLA L. REV. 1269, 1282 (1981).

22. "The morality of altruism is supposed to animate" the traditional notion of family. Olsen, *The Family and the Market: A Study of Ideology and Legal Reform*, 96 HARV. L. REV. 1497, 1505 (1983).

23. It appears that the statutes of over 30 states, including North Carolina, make specific provision for consideration of homemaker services upon divorce. *See* Note, *Property Division and Alimony Awards: A Survey of Statutory Limitations on Judicial Discretion*, 50 FORDHAM L. REV. 415, 428 (1981); Note, *The Need to Value Homemaker Services Upon Divorce*, 87 W. VA. L. REV. 115, 124 (1984) [hereinafter Note, *Homemaker Services*].

24. Various statistical formulations have been developed to measure both the "replacement cost" and the "lost opportunity" value of homemaker services. For a good summary of these studies, see Note, *Homemaker Services*, *supra* note 23, at 125-27, in which the replacement cost for a mother of two preschool children is estimated at $44,436 per year. Not surprisingly, the results of such studies have been largely ignored in most judicial decisions. Thus, as the author notes, although the decision for one spouse to work at home is made jointly, "the burden of the joint decision is disproportionately borne by the wife" upon divorce. *Id.* at 121; *see also* Beninger & Smith, *Career Opportunity Cost: A Factor in Spousal Support Determination*, 16 FAM. L.Q. 201, 206-07 (1982) (discussing the short- and long-term opportunity costs of a couple's decision for the wife to work at home).

ship ideal is a rather amorphous concept. In addition, as commentators increasingly have begun to note, the partnership ideal is not without serious deficiencies, both analytically and practically.[25] Particularly within a classification-based distributional system[26] that defines or preserves separate property to an extensive degree, sharing principles may be greatly diluted in favor of a more individualistic model.[27] Furthermore, it appears that the partnership ideal generally fails to provide adequate compensation for the lost opportunity costs to spouses who invest the majority of their talents and energies in homemaking or child-rearing activities.[28] It also seems clear that an insistence on a formally egalitarian treatment upon divorce of spouses who may possess vastly different

25. *See generally* Olsen, *supra* note 22 (noting the degree to which the individualistic values of the marketplace have pervaded the ideology of the family). Professor Prager also discusses the potentially unfair results of the "individualistic orientation of the separate property model." Prager, *supra* note 21, at 12. For a discussion of some of the practical problems associated with implementation of the principle, see *infra* notes 128-29.

26. The major feature of a classification-based system for distribution of property upon divorce is that separate property is immunized from judicial distribution. The system derives from the community property distinction between "onerous" property, which is acquired through the labor or efforts of either spouse, and "lucrative" property, which is acquired without the benefit of any marital effort. *See* Comment, *What's Yours is Mine and What's Mine is Mine: The Classification of the Home Upon Dissolution*, 28 UCLA L. REV. 1365 (1981). Jurisdictions other than North Carolina that have adopted this system include Colorado, Delaware, the District of Columbia, Illinois, Kentucky, Maryland, Minnesota, Missouri, New York, Pennsylvania, New Jersey, Rhode Island, Tennessee, Virginia, and West Virginia. Other common-law states allow, at least in some limited circumstances, all property of either spouse to be divided. *See* Sharp, *supra* note 6, at 249-50.

27. This danger is particularly great in North Carolina, given its statute's generally expansive definition of separate property. *See infra* text accompanying note 144. As Professor Prager has observed, the separate property "individually oriented model works to reward self-interested choices which can be detrimental to the continuation of the marriage. At the same time it punishes conduct of accommodation and compromise so important to furthering and preserving the relationship." Prager, *supra* note 21, at 12; *see also* Fineman, *Implementing Equality: Ideology, Contradiction and Social Change*, 1983 WIS. L. REV. 789. In particular, Professor Fineman points out that the partnership ideal embodies a "rule equality" model, which in turn is founded on the basic proposition that the existence of equal opportunities for husbands and wives is sufficient to create true equality. *Id.* at 826. Thus, it ignores the actual economic inequality, future needs of the parties, and the future inequalities that are likely to result from divorce. *Id.* at 830. Equal results, she argues, can only be obtained from a system that distributes property unequally, in favor of a dependent, and especially a custodial, spouse. *Id.* at 839-42; *see also* Powers, *Sex Segregation and the Ambivalent Directions of Sex Discrimination Law*, 1979 WIS. L. REV. 55 (individualist perspective less effective than participatory perspective in combating sex discrimination). In M. GLENDON, THE NEW FAMILY AND THE NEW PROPERTY 61-65 (1981), the author argues forcefully that partnership principles are particularly inequitable, and inept, in dealing with the needs of children and custodial parents.

28. A dependent spouse's investment in such "marriage-specific" capital can be risky indeed. As one commentator has noted, a "wife is willing to invest in her husband's earning capacity at cost to herself only because he directly compensates her during the period of investment or because she has a claim to future earnings generated by her investment. Although the total value of the husband's earnings is not at risk by divorce, the wife's claim is at risk and her incentive to invest is directly affected by this risk." Landes, *Economics of Alimony*, 7 J. LEGAL STUD. 35, 45 (1978); *see also* Bruch, *Property Rights of De Facto Spouses Including Thoughts on the Value of Homemakers' Services*, 10 FAM. L.Q. 101 (1976) (noting the inherent economic value of domestic services); Freedman, *Sex Equality, Sex Differences and the Supreme Court*, 92 YALE L.J. 913 (1983) (examining sex discrimination decisions of the Supreme Court); Krauskopf, *Recompense for Financing Spouse Education: Legal Protection for the Marital Investor in Human Capital*, 28 U. KAN. L. REV. 379 (1980) (recognizing the need for judicial recognition of human capital); Scales, *Towards A Feminist Jurisprudence*, 56 IND. L.J. 375, 442 (1981) (concluding that "[c]hief among any proposals for reform is the re-evaluation of family law schemes which promote the financial dependence of women upon men and which devolve upon women all the financial risks resulting from the breakup of a relationship").

economic potentials can have quite detrimental effects on economically disadvantaged spouses and children.[29]

In spite of these criticisms, the adoption of the partnership model has undoubtedly had significant positive benefits in North Carolina. At the most obvious level, some recognition of the value of homemaker contributions is considerably better than none.[30] More significantly, the partnership principle has been the critical factor in persuading courts to adopt, in many instances, a broad and truly remedial interpretation of the statute—a result that, given the generally conservative nature of the statute, might have been difficult to obtain in the absence of such a guiding principle.[31] The influence of the partnership principle is readily apparent in the interpretation of each of the mandatory, and distinct, stages of equitable distribution—definition, valuation, and distribution.[32] It has been most invaluable, however, in the definitional stage, because it is clear that no genuinely equitable distribution of property is possible unless the pool of divisible assets has been defined equitably in the first instance.[33]

III. DEFINITION—MARITAL PROPERTY

A word of caution is appropriate before beginning this discussion. As noted previously, the general principles that will continue to govern the processes of equitable distribution in North Carolina are already clear. Implementation and refinement of those principles, however, are different matters. Equitable distribution, particularly at a practical level, is an extremely complex process. In many instances the court of appeals, on which virtually the entire burden of interpreting the Act has fallen thus far, is still struggling through an analytical

29. *See* Fineman, *supra* note 27, at 829-32; Glendon, *Family Law Reform in the 1980's*, 44 LA. L. REV. 1553 (1984). Forced sale of the marital home when couples who divorce have children is a particularly good example of an immediate, and often traumatic, effect of property division on children. One quite famous study from California, for example, found that 66% of couples who were forced to sell the marital home had minor children. In general, it appeared that the presence of minor children did not affect a custodial parent's chances of being awarded the home, despite a statutory directive that such a factor be considered. L. WEITZMAN, THE DIVORCE REVOLUTION: THE UNEXPECTED SOCIAL AND ECONOMIC CONSEQUENCES FOR WOMEN AND CHILDREN IN AMERICA 79 (1985). Similar results have been obtained from other studies. *See, e.g.*, McGraw, Sterin & Davis, *A Case Study in Divorce Law Reform and Its Aftermath*, 20 J. FAM. L. 443 (1981-82) (results of a 13 year study on the effects of divorce reform in Ohio).

30. As the supreme court noted, with remarkable understatement, in White v. White, 312 N.C. 770, 324 S.E.2d 829 (1985), the previous title system had indeed been guilty of "overlooking" this contribution. *Id.* at 774, 324 S.E.2d at 831.

31. *See* Sharp, *supra* note 6, at 271. The statute does nonetheless impose some unavoidable restrictions on implementation of partnership principles. Nonvested pension and retirement benefits, for example, are separate property. *See infra* note 35.

32. In a series of cases the court of appeals has emphasized that the stages are both mandatory *and* distinct from one another. *See* Dorton v. Dorton, 77 N.C. App. 667, 669-70, 336 S.E.2d 415, 418 (1985); Cable v. Cable, 76 N.C. App. 134, 137, 331 S.E.2d 765, 767 (1985); Little v. Little, 74 N.C. App. 12, 16, 327 S.E.2d 283, 287 (1985); Turner v. Turner, 64 N.C. App. 342, 345, 307 S.E.2d 407, 408-09 (1983). Thus, the definition of marital property has been able to proceed largely without reference to the often confusing distributional factors.

33. Even the most generous exercise of judicial discretion at the distributional stage cannot compensate adequately for an unnecessarily limited definition of marital property in the first instance. Therefore, an expansive definition of marital property is an absolute precondition for achievement of the equitable and remedial goals of the statute. *See* Sharp, *supra* note 6, at 271.

thicket. In some cases, the court appears simply to have addressed precipitously issues that were not actually before it. With other issues, there appears to be genuine confusion and occasional outright inconsistency. Thus, it is important to guard against reading too much into opinions and language that often should properly be regarded only as steps, and occasional missteps, in an ongoing developmental process.

A. *Preliminary Issues*

The threshold, and the most critical, requirement of the statute is that a court determine what is marital, and therefore distributable, property.[34] The lengthy definition of marital property in North Carolina General Statute section 50-20(b)(1) is somewhat atypical: it includes "all real and personal property acquired by either spouse or both spouses during the course of the marriage and before the date of the separation of the parties, and presently owned, except property determined to be separate property."[35] The expansive definition of separate property contained in the next section of the statute, however, is distinctly atypical.[36] The result was that North Carolina courts confronted at the outset the extremely difficult task of attempting to reconcile broad remedial statutory purposes and policies with specific statutory provisions that could well have undermined those same principles. That this process has produced some confusing, and at times, unfortunate decisions, does not detract from the generally sound results that the courts nonetheless have achieved.

The most significant question initially confronting the North Carolina courts was whether the language of section 50-20(b)(1) created a presumption

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34. Alexander v. Alexander, 68 N.C. App. 548, 550, 315 S.E.2d 772, 775 (1984).

35. N.C. GEN. STAT. § 50-20(b)(1) (Supp. 1985). This is an expanded version of the original statute. A 1983 amendment added the language "or both spouses" and "before the date of the separation of the parties." Act of June 29, 1983, ch. 640, § 1, 1983 N.C. Sess. Laws 599, 599 (codified at N.C. GEN. STAT. § 50-20(b)(1) (Supp. 1985)). For a discussion of the purposes of these amendments, see *infra* text accompanying notes 45-49.

Under the original version of the Act, all pension and retirement benefits were separate property. Act of July 3, 1981, ch. 815, § 1, 1981 N.C. Sess. Laws 1184, 1184, *amended by* Act of July 14, 1983, ch. 758, § 1, 1983 N.C. Sess. Laws 787, 787. In 1983, however, the general assembly amended the statute to provide that marital property "includes all vested pension, retirement, and other deferred compensation rights . . . ." Act of July 14, 1983, ch. 758, § 1, 1983 N.C. Sess. Laws 787, 787 (codified at N.C. GEN. STAT. § 50-20(b)(1) (Supp. 1985)). Nonvested benefits remain separate property and are, under N.C. GEN. STAT. § 50-20(c)(5) (Supp. 1985), to be considered as a distributional factor.

36. North Carolina General Statute section 50-20(b)(2) defines as separate property:

> all real and personal property acquired by a spouse before marriage or acquired by a spouse by bequest, devise, descent, or gift during the course of the marriage. However, property acquired by gift from the other spouse during the course of the marriage shall be considered separate property only if such an intention is stated in the conveyance. Property acquired in exchange for separate property shall remain separate property regardless of whether the title is in the name of the husband or wife or both and shall not be considered to be marital property unless a contrary intention is expressly stated in the conveyance. The increase in value of separate property and the income derived from separate property shall be considered separate property. All professional licenses and business licenses which would terminate on transfer shall be considered separate property.

N.C. GEN. STAT. § 50-20(b)(2) (Supp. 1985).

The statute also excludes from marital property "[t]he expectation of nonvested pension, retirement, or other deferred compensation rights." *Id.*

of marital property. Although the statute seemed to suggest such a conclusion, and similar statutes in other states had been interpreted to create a marital property presumption,[37] the result in North Carolina was by no means a foregone conclusion.[38] In *Loeb v. Loeb*,[39] however, the court of appeals, relying in no small part on the "economic partnership" model, held that the statute did indeed create a presumption that "all property acquired . . . during . . . marriage" is marital.[40] It went on to hold that the presumption is rebuttable only by "clear, cogent, and convincing evidence that the property" in question is separate.[41] Thus far there have been relatively few cases in which the effect of this presumption has been critical.[42] The presumption remains significant, however, both practically, because the burden of proof must always be borne by the party claiming an asset as separate,[43] and symbolically, as a reminder of underlying statutory principles.

More specific aspects of the marital property definition are also worth noting. The 1981 version of the Act did not contain the phrase "or both spouses," included by amendment in language that now reads "all property acquired by either spouse or both spouses."[44] The amendment apparently was intended to remove any doubt that jointly owned property might not be considered distributable;[45] the *Loeb* court, however, had already come to that conclusion under the original version of the Act.[46] Certainly, it is now clear that jointly-held

37. *See, e.g.*, Hemily v. Hemily, 403 A.2d 1139 (D.C. 1979); Searcy v. Searcy, 658 S.W.2d 931 (Mo. Ct. App. 1983); Painter v. Painter, 65 N.J. 196, 320 A.2d 484 (1974). The statutes of several other states contain an explicit presumption of marital property. *See, e.g.*, ILL. ANN. STAT. ch. 40, para. 503(c) (Smith-Hurd 1980); KY. REV. STAT. ANN. § 403.190(3) (Michie/Bobbs-Merrill Supp. 1986).

38. In Wade v. Wade, 72 N.C. App. 372, 381, 325 S.E.2d 260, 269 (1985), the court of appeals observed, in dicta, that it found nothing in the North Carolina Act that "indicates a legislative preference for the classification of property as marital"; instead it discerned a legislative intent "that separate property brought into the marriage . . . be returned to that spouse." *Id.* The marital property presumption is not, however, inconsistent with a policy of preserving the separate identity of separate property.

39. 72 N.C. App. 205, 324 S.E.2d 33, *cert. denied*, 313 N.C. 508, 329 S.E.2d 393 (1985).

40. *Id.* at 209, 324 S.E.2d at 38.

41. *Id.* at 210, 324 S.E.2d at 38. This is the same standard of proof required to rebut both the common-law presumption of gift between spouses under Mims v. Mims, 305 N.C. 41, 286 S.E.2d 779 (1982), and the presumption under the new Act that interspousal gifts are marital. Dewey v. Dewey, 77 N.C. App. 787, 336 S.E.2d 451 (1985).

42. In McManus v. McManus, 76 N.C. App. 588, 334 S.E.2d 270 (1985), the husband claimed that certain stocks had been a gift of separate property from his father. His testimony to that effect, plus the fact the stock had been acquired during the marriage, was the only evidence before the court. *Id.* at 591, 334 S.E.2d at 273. Over one dissent, see *id.* at 594, 334 S.E.2d at 274 (Becton, J., dissenting), the court held that the husband's testimony was insufficient to rebut the marital property presumption. *Id.* at 591, 334 S.E.2d at 273. It would appear that the majority was correct; to allow, as a matter of law, the unsubstantiated testimony of one spouse—whom the trial court found not particularly credible for a variety of reasons—to overcome the presumption would render it rather meaningless. Similarly, in *Loeb* the wife was unable to overcome the presumption to establish that gifts from her mother should have been classified as separate property. *Loeb*, 72 N.C. App. at 212-13, 324 S.E.2d at 39-40.

43. *Loeb*, 72 N.C. App. at 210, 324 S.E.2d at 38. The presumption will thus be of greatest use when it would be difficult, or impossible, to trace out the separate sources of commingled property. *See infra* text accompanying notes 141-42.

44. *See* N.C. GEN. STAT. § 50-20(b)(1) (Supp. 1985); *supra* note 35.

45. This was a possibility that was raised, only in passing, in Sharp, *supra* note 6, at 252.

46. The amendment was not in effect at the time *Loeb* was tried, but the court of appeals held

property, like all other property acquired during marriage and before separation, is presumptively marital, and, if marital, is subject to equitable distribution.[47]

A second amendment to the original version of the marital property definition merits more attention. In 1983 the general assembly added to the "acquired during the marriage" phrase the further qualifying language "and before the date of the separation of the parties."[48] This amendment thus settled a very important issue that the general assembly had not addressed in the original version of the Act: the date at which the marriage would be deemed to terminate for purposes of accumulation and valuation of marital property.[49] Identification of the date of mere physical separation with the date for cessation of marital property acquisition is, however, a unique, and potentially troublesome solution to a problem faced in all equitable distribution states.[50] It may create difficulties, for example, with property whose value may substantially appreciate or depreciate during the year-long separation period required for divorce in North Carolina.[51] It also leaves open the possibility that even a brief reconciliation by the parties could have a substantial effect on the ultimate composition of the marital estate.[52]

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that the jointly held property at issue therein was nonetheless subject to distribution. *Loeb*, 72 N.C. App. at 210, 324 S.E.2d at 38.

47. As the court of appeals noted in McLeod v. McLeod, 74 N.C App. 144, 327 S.E.2d 910, *cert. denied*, 314 N.C. 331, 333 S.E.2d 488 (1985), the "nature of a tenancy by the entirety does not insulate it from legislative change." *Id.* at 152, 327 S.E.2d at 916.

48. *See* Act of July 9, 1985, ch. 660, § 1, 1985 N.C. Sess. Laws 847, 847 (codified at N.C. GEN. STAT. § 50-20(b)(1) (Supp. 1985)).

49. *See* Sharp, *supra* note 6, at 251-52; *infra* note 51.

50. *See* Sharp, *supra* note 6, at 251-52; *see also* Stallings v. Stallings, 606 S.W.2d 163 (Ky. 1980) (discussing the practical difficulties and potentially inequitable results that can be encountered with the use of the date of physical separation as the accumulation and valuation date).

51. Under the amended version of another part of N.C. GEN. STAT. § 50-20(b) (Supp. 1985), marital property will also be valued as of the date of separation, assuming that the divorce is based on one year's separation. Under N.C. GEN. STAT. § 50-20(c)(11a), courts may consider as a distributional factor "[a]cts of either party to maintain, preserve, develop, or expand; or to waste, neglect, devalue or convert such marital property, during the period after separation of the parties and before the time of distribution." *See infra* text accompanying notes 77, 345. Marked increases or decreases in the value of property not caused by either party's acts between the date of separation and the date of the equitable distribution action could, it seems clear, also be considered under N.C. GEN. STAT. § 50-20(c)(12), as an "any other" distributional factor. The court of appeals approached such a result in Johnson v. Johnson, 78 N.C. App. 787, 338 S.E.2d 567 (1986), in which it held that a lower court had properly considered as a distributional factor that the wife's separate property had decreased in value during the marriage, owing to activities that had enriched the marital estate. *Id.* at 790, 338 S.E.2d at 569. In this context, however, it seems that a narrow definition of marital property cannot adequately be compensated for by the possibility of a distributional adjustment.

52. North Carolina courts have consistently held that either a resumption of cohabitation or the occurrence of sexual intercourse between the parties will, in effect, "nullify" the separation, start the year's waiting period running anew, and void any separation agreement entered into by the parties. *See* Murphy v. Murphy, 295 N.C. 390, 245 S.E.2d 693 (1978) (several acts of intercourse between the spouses with no resumption of cohabitation); *In re* Estate of Adamee, 291 N.C. 386, 230 S.E.2d 541 (1976) (resumption of cohabitation). If the courts were to apply these well-established rules in this context, the possibility exists that either party might be deterred from attempting reconciliation for fear that both the pool and the value of marital assets would change, or that a party might attempt reconciliation for the sole purpose of causing such a change. Neither alternative seems particularly attractive, and each would appear to violate the public policy that favors the preservation of marriage by encouraging reconciliation. It is largely for this reason that the overwhelming majority of states have chosen as the termination date an event, such as the filing of an action, that more accurately symbolizes the true end of the marriage. *See* Sharp, *supra* note 6, at

The date of separation amendment also appeared to create the possibility that assets acquired in one party's name, but with marital funds, might be classified as separate *solely* on the grounds that these assets were purchased after separation. The court of appeals quickly put this notion to rest, however. Indeed, several cases have made clear that property may not be excluded from classification as marital by such a literal interpretation of the statute.[53] *Mauser v. Mauser*,[54] probably the leading case addressing this issue, laid down an unequivocable rule: whether the assets in question are marital or separate depends not on whether they were technically acquired before or after separation, but rather on whether the funds used for acquisition were marital or separate.[55] As the court succinctly put the matter, "[c]onversion of property between the date of separation and the date of divorce simply has no effect on its character as either marital or separate."[56] A contrary result would, the court realized, "only create an incentive for a spouse to convert marital assets . . . as soon as the parties separated" and would thereby undermine the very purpose of the Act.[57]

Thus, it is quite clear that property acquired after separation with marital funds will not lose its character as marital. It is possible, however, that such after-acquired property might lose the benefit of the marital property presumption. One case has at least implicitly reached this result in holding that property acquired after separation would be separate unless its purchase could be traced to marital funds.[58] Moreover, this conclusion is consistent with the literal language of *Loeb v. Loeb*[59] and with the amended version of the statute.[60] Thus, the sometimes ironic result could be that a party who wrongfully had attempted to convert marital assets to separate property nonetheless would be able to shift any tracing burden to the other spouse.[61]

A final issue that is likely to arise with interpretation of this section is the classification of property that a spouse earns the right to receive during mar-

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251-52. It should be noted, however, that the court of appeals recently has begun to attempt to soften the Draconian effect of the *Murphy* rule. *See, e.g.*, Camp v. Camp, 75 N.C. App. 498, 331 S.E.2d 163 (1985) (mutual intent to reconcile is essential when there is conflicting evidence on whether sexual relations occurred). The issue nonetheless remains a serious problem.

53. *See* Talent v. Talent, 76 N.C. App. 545, 555, 334 S.E.2d 256, 262 (1985); Phillips v. Phillips, 73 N.C. App. 68, 75, 326 S.E.2d 57, 61 (1985); Wilson v. Wilson, 73 N.C. App. 96, 100, 325 S.E.2d 668, 670 (1985). In *Talent* the court stated, "The fact that this marital property was used to acquire other property after the date of the parties' separation did not cause it to lose its marital character." *Talent*, 76 N.C. App. at 555, 324 S.E.2d at 262.

54. 75 N.C. App. 115, 330 S.E.2d 63 (1985).

55. *Id.* at 118, 330 S.E.2d at 65-66. The holding was based in part on the application of the source of funds theory, which had been adopted in earlier cases and which is discussed in detail *infra* text accompanying notes 83-134. That theory is not necessary to reach the *Mauser* result, however.

56. *Mauser*, 75 N.C. App. at 119, 330 S.E.2d at 65. It also has no effect on value, because property must be valued as of the date of separation. *See supra* note 51.

57. *Mauser*, 75 N.C. App. at 119, 330 S.E.2d at 65.

58. Wilson v. Wilson, 73 N.C. App. 96, 100, 325 S.E.2d 668, 680 (1985). However, it was unclear when the property at issue in *Wilson* had been purchased. *Id.* at 100, 325 S.E.2d at 671.

59. 72 N.C. App. 205, 324 S.E.2d 33, *cert. denied*, 313 N.C. 508, 329 S.E.2d 393 (1985).

60. *Id.* at 209, 324 S.E.2d at 38.

61. Although no court has precisely addressed this issue, as a practical matter, tracing burdens do appear to have been shifted in a number of cases. *See* Talent v. Talent, 76 N.C. App. 545, 334 S.E.2d 256 (1985); Phillips v. Phillips, 73 N.C. App. 68, 326 S.E.2d 57 (1985); Wilson v. Wilson, 73 N.C. App. 96, 325 S.E.2d 668 (1985).

riage, but that is not actually received until after separation. Under the *Mauser* analysis such property should be considered marital, assuming that it would have warranted that classification had it been received during marriage. Ample precedent has already established that property acquired after separation with marital funds remains marital;[62] moreover, it takes but a small step to conclude that the result should not differ when marital efforts "earned" the right to receive property at a later date. As noted previously, a contrary result could encourage spouses to delay receipt of the asset purposefully. Moreover, even in the absence of such an intent to deny compensation to the marital estate, the date on which such an asset is acquired is likely to be pure happenstance.

A few cases have already reached this result implicitly by including, as part of the valuation of business enterprises, both accounts receivable and the value of goodwill.[63] The issue is likely to be confronted more directly, however, when the asset received after separation is one of substantial value, such as insurance or personal injury proceeds,[64] or contingent fee awards.[65] The result, however, should not differ: assets or funds earned by the marital community should be credited to it.

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62. *See supra* notes 53-57 and accompanying text.

63. *See, e.g.*, McManus v. McManus, 76 N.C. App. 588, 592, 334 S.E.2d 270, 273 (1985); Poore v. Poore, 75 N.C. App. 414, 331 S.E.2d 266 (1985); Weaver v. Weaver, 72 N.C. App. 409, 324 S.E.2d 915 (1985). One case from another jurisdiction worthy of note in this context is *In re* Marriage of Bayer, 687 P.2d 537 (Colo. Ct. App. 1984), which allowed husband lawyer's accounts receivable to be discounted by 10% percent for uncollectibility.

64. The status of personal injury awards was for a time somewhat uncertain in North Carolina. Little v. Little, 74 N.C. App. 12, 327 S.E.2d 283 (1985), held that a $100,000 insurance payment was marital property, on the grounds that the money was used to provide for "his family as he presumably would have done had he not been injured." *Id.* at 17, 327 S.E.2d at 288. In Johnson v. Johnson, 75 N.C. App. 659, 331 S.E.2d 211 (1985), however, the opposite result was reached, with two judges concurring in the result solely because the settlement was received *after* separation. On appeal, the supreme court remanded *Johnson* and, following the lead of community property states, held that those portions of a personal injury award that represented compensation for pain and suffering, disfigurement, and post-separation disability and loss of earning capacity should be classified as separate property. Johnson v. Johnson, No. 471PA85, slip op. at 22 (N.C. Aug. 1986). Given the presumption of marital property, however, the party seeking to claim a portion of a recovery award as separate property has the burden of proving "what amount or proportion of the whole represents compensation for loss . . . of his . . . 'separate property.' " *Id.* at 22. The supreme court characterized its resolution of this issue as an "analytical," as opposed to a "mechanistic" approach to the distribution of such compensatory awards. *Id.* at 18. Presumably, the court would adopt the same approach with, for example, workers' compensation or other disability awards. *But see supra* text accompanying notes 62-63 (property acquired after marriage with marital funds is marital property). The more common results are illustrated by such cases as Mosley v. Mosley, 682 S.W.2d 462 (Ky. Ct. App. 1983) (worker compensation and black lung benefits received prior to dissolution marital property), and *In Re* Marriage of Fjeldhein, 676 P.2d 1234 (Colo. Ct. App. 1983) (settlement offer made at time of trial but not yet accepted should be marital property). *See also* Note, *Dissolution of Marriage—Personal Injury Damages as Marital Property in Missouri*, 41 MO. L. REV. 603 (1976) (personal injury suit settlements should be part marital property—compensate loss to marital community, and part personal property—compensate individual for personal injuries).

65. Courts normally will classify that portion of a contingent fee received as compensation for work done during marriage as marital property. *See, e.g.*, Garrett v. Garrett, 140 Ariz. 564, 683 P.2d 1166 (Ariz. Ct. App. 1984) (wife's interest in any ultimate recovery should be in proportion to the marital efforts spent by attorney-husband on contingency fee cases he worked on during marriage).

B. *"Presently Owned" Property*

The "presently owned" language of North Carolina General Statute section 50-20(b)(1) was, from its inception, sorely in need of judicial interpretation.[66] Applied literally the language would appear to be an invitation to a spouse to insulate marital assets from distribution by the simple expedient of disposing of them between the date of separation and the date of divorce. This was, in fact, precisely what the wife in *Talent v. Talent*[67] apparently attempted to do; she took 68,000 dollars of marital property from savings and certificates of deposit, then claimed at trial that only that portion of the fund she still had could be considered marital property, because the remainder was not "presently owned."[68] Not surprisingly, the court of appeals upheld the trial court's determination that the entire fund should be included as marital property; the "presently owned" clearly refers to the date of separation, not the time of trial.[69] In a second case dealing with similar facts, the court of appeals was even willing to draw an inference that a cash fund had been "owned" at the date of separation.[70] These results follow naturally from application of a source of funds approach[71] and from the line of cases already discussed creating the rule that an attempt to convert marital property after separation cannot result in the reclassification of such property as separate.[72] There should be no substantive distinction in the treatment of marital property that is converted to separate property or that is converted to a separate *use*.

In fact, it seems that property has thus far been exempted from inclusion in the marital asset pool on the ground that it was not "presently owned" in only one limited circumstance: when the evidence showed that the spouses had made

66. " 'Marital property' means all real and personal property acquired by either spouse or both spouses during the marriage, and before the date of the separation . . . and presently owned . . . ." N.C. GEN. STAT. § 50-20(b)(1) (Supp. 1985).

67. 76 N.C. App. 545, 334 S.E.2d 256 (1985).

68. *Id.* at 553, 334 S.E.2d at 261.

69. *Id.* The court observed that "the $68,000 was an asset of the marriage which appellant took and used as her separate property . . . . [T]hus, she should be required to account for it." *Id.* at 553, 334 S.E.2d at 262. A second issue in *Talent* worthy of note involved a $16,000 cash fund that had been kept in a safe in the parties' home. By the time of trial, the fund had "disappeared," with both parties denying any knowledge thereof. With little discussion, the court of appeals upheld the trial court's failure to include this sum as marital property. *Id.* at 551-53, 334 S.E.2d at 260-62. It would appear that neither party was able to prove when, or even if, the other had appropriated the fund for his or her own use.

70. In McManus v. McManus, 76 N.C. App. 588, 334 S.E.2d 270 (1985), the husband claimed that a $9,799 marital cash fund should not have been included as marital property because there was no evidence that he "presently" owned it. The evidence did show, however, that he had had the fund one month before separation and that its disposition was unaccounted for by any repayment of debt or other appropriate marital use. This was sufficient, held the court, to permit an inference that he had owned the fund at the date of separation, so that its inclusion as marital property was proper. *Id.* at 591-92, 334 S.E.2d at 273-74. In effect, the court placed the burden of proof on the husband to show that a fund within his control had been used for marital purposes, in order to have the money excluded from the pool of marital assets on the ground that it was not "owned" at the date of separation.

71. *See infra* text accompanying note 106.

72. *See supra* text accompanying notes 53-60. These cases, however, do not specifically rely on a source of funds analysis.

a joint gift of property to their children.[73] There is, of course, a substantial guarantee that a transfer to children of the parties is not tainted with any wrongful desire or intent to diminish the pool of marital assets available for distribution.[74] However, even such gifts should be subject to rebuttal, using the same "clear, cogent, and convincing" standard that has been applied in other contexts.[75] Moreover, gifts to other third parties should be carefully subjected to at least the same kind of scrutiny, and courts should be particularly wary of gifts made by one spouse shortly before separation.

In general it appears that any exemption from the marital property definition on the grounds that the property in question is not "presently owned" will be strictly limited. That language clearly has been interpreted to refer only to property owned at the time of separation. Thus, only property that has been disposed of or has been used for legitimate marital purposes, such as joint gifts to children, should be a proper object for exclusion under this section.[76]

Courts have interpreted both the "acquired after separation" and the "presently owned" qualifications on the definition of marital property in a sensible and restrained fashion, so as to narrow the opportunities for spouses to squander or wrongfully reduce the pool of marital assets for purposes that are essentially separate. Such a restrained interpretation of the statute is critical to its operation. Parties who are seeking a divorce often are not disposed to treat one another fairly: with almost predictable regularity they will attempt to manipulate assets to the detriment of the marital estate.[77]

The availability of injunctive relief procedures that can, at least theoretically, prevent such behavior in the first instance does not at all lessen the neces-

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73. In Weaver v. Weaver, 72 N.C. App. 409, 418-19, 324 S.E.2d 915, 921 (1985), the court found that a $3,800 piano had been a gift from the parties to their children; thus, it was not "presently owned" and should not have been included as part of marital assets. In Andrews v. Andrews, 79 N.C. App. 228, 235, 338 S.E.2d 809, 814 (1986), the appellate court found no error in the trial court's failure to include as marital property a beach house given to the parties' children. In *Andrews*, however, defendant-husband had failed either to claim or identify the house as marital property in any of the earlier proceedings. *Id.*

74. Gifts to children of one party by a previous marriage are, of course, substantially more suspect than gifts to joint children of the parties.

75. Loeb v. Loeb, 72 N.C. App. 205, 210, 324 S.E.2d 33, 38, *cert. denied*, 313 N.C. 508, 329 S.E.2d 393 (1985). If attempts are made to rebut the gift, at least one case suggests that the children might have to be joined as parties. *See* Andrews v. Andrews, 79 N.C. App. 228, 235, 338 S.E.2d 809, 814 (1986). An easier alternative in most instances, however, would be simply to include the value of the gift in the marital estate.

76. Marital property that is converted to or used for separate purposes will, in the majority of states, be reincluded in the pool of marital assets. As one court noted, although such conduct may not be "per se fraudulent," it is nonetheless wrongful. *In re* Marriage of Posinoff, 683 P.2d 377, 378 (Colo. Ct. App. 1984).

77. *See* Sharp, *Fairness Standards and Separation Agreements: A Word of Caution on Contractual Freedom*, 132 U. PA. L. REV. 1399 (1984). In many common-law states the presumption that a confidential relationship exists between the spouses imposes good faith obligations on them. In community property states a fiduciary duty is likely to be imposed with respect to community property assets. *Id.* at 1414-17. Neither theory is likely to be particularly effective in deterring such conduct in North Carolina, however. The confidential relationship between spouses dissipates readily after separation. *See, e.g.*, Murphy v. Murphy, 34 N.C. App. 677, 680-81, 239 S.E.2d 597, 599-600, *rev'd on other grounds*, 295 N.C. 390, 245 S.E.2d 693 (1978). The statute does not, moreover, create any "vested" rights to marital property prior to divorce. *See* Wilson v. Wilson, 73 N.C. App. 96, 99, 325 S.E.2d 668, 670 (1985) (interpreting N.C. GEN. STAT. § 50-20(k) (Supp. 1985)).

sity that there be remedies, in the form of reinclusion in the marital estate, for such wrongful conduct. This argument apparently was made before, and rejected by, the court of appeals in *Mauser v. Mauser*.[78] The issue is of considerable practical importance, however, and deserves closer examination.

There are at least two sound reasons for ignoring the availability of injunctive relief at the definitional stage. First, parties ought not be penalized for failure to anticipate spousal attempts to convert marital property to separate property use. A spouse may well be unaware of the existence of such property, the intentions of the other with regard to it, or even the feasibility of obtaining relief. It is also possible that a spouse would be unable to afford either the attorney's fees or the security bond required to obtain injunctive relief.[79] Clearly, the failure to prevent wrongful conduct, especially in this context, should be irrelevant to obtaining appropriate remedies for such conduct.

Second, injunctive relief may, as the court of appeals pointed out in *Mauser*, be difficult to obtain.[80] The rather strict standards that are applied in North

78. 75 N.C. App. 115, 118, 330 S.E.2d 63, 65 (1985). *Mauser* held that the conversion of marital property to separate property after the separation of the parties would have no effect on its classification as marital. The court also observed that "the availability of injunctive relief has no bearing upon our result." *Id.* at 119, 330 S.E.2d at 66. The current version of N.C. GEN. STAT. § 50-20(i) (Supp. 1985), allowing a party to seek injunctive relief "to prevent the disappearance, waste or conversion" of property when an action for equitable distribution is filed *or* when it is alleged that such an action will be requested "when it is timely to do so," was not in effect when *Mauser* was tried. The original version of the statute was phrased in such a way that injunctive relief could not have been available until after a party had actually filed for equitable distribution—*i.e.*, until the parties had been separated for a full year. In its initial form, therefore, this provision was of virtually no help whatsoever. As the *Mauser* court noted, however, the statutory revision would not have affected its conclusion. *Mauser*, 75 N.C. App. at 118, 330 S.E.2d at 65.

It should also be noted that under subsection (h) of the statute, a party claiming any real property as marital may file a notice of *lis pendens* to protect such property. The opposing party may have the notice cancelled by posting a bond in lieu thereof. N.C. GEN. STAT. § 50-20(h) (1984).

79. Rule 65(c) requires that "[n]o restraining order or preliminary injunction shall issue except upon the giving of security by the applicant" for the payment of costs or for any damages suffered by the party who might be wrongfully restrained. N.C.R. CIV. P. Rule 65(c) (1983). Attorneys' fees and costs are available only when the injunctive relief that applicant seeks is for return of his or her separate property which was removed by the other, and only so long as such fees do not "exceed the fair market value of the separate property at the time it was removed." N.C. GEN. STAT. § 50-20(i) (Supp. 1985). This extremely limited form of relief is nonetheless all that is available under the North Carolina statute. Thus, the legal fees and costs alone might severely discourage some spouses from seeking injunctive relief. A factor that courts may now consider in the distribution of property includes any "[a]cts of either party to . . . waste, neglect, devalue or convert such marital property, during the period after separation of the parties and before the time of distribution." *Id.* § 50-20(c)(11a). This section should be regarded, however, as an "if all else fails" remedy. It is clear, in addition, that courts should not consider such distributional factors at the definitional stage. *See* Cable v. Cable, 76 N.C. App. 134, 137, 331 S.E.2d 765, 767 (1985). Thus, the only effective remedy for acts that waste or convert marital property is reinclusion of those assets, or their value, in the pool of marital assets.

80. *Mauser*, 75 N.C. App. at 119, 330 S.E.2d at 66. N.C.R. CIV. P. § 1A-1, Rule 65(b) (1983) requires a showing that "immediate and irreparable injury, loss or damage will result," and N.C. GEN. STAT. § 1-485(3) (1983) requires in addition that there be a showing that the party against whom relief is sought "threatens or is about to remove or dispose of his property, with intent to defraud the plaintiff." Cases have emphasized, moreover, that the injury must be "actually threatened and practically certain, not one anticipated and merely probable." Duke Power Co. v. City of High Point, 69 N.C. App. 335, 337, 317 S.E.2d 699, 700 (1984); *see also* Hooks v. International Speedways, Inc., 263 N.C. 686, 140 S.E.2d 387 (1965) (injunction sought for anticipated nuisance). This creates a standard of proof that would be extremely difficult to meet in most domestic cases. Moreover, as the *Mauser* court also noted, injunctive relief offers nothing, in any case, to

Carolina basically create a situation in which injunctive relief can operate only to protect known rights, to identifiable property, in the face of immediate and unmistakable threat.[81] The limited degree to which injunctive relief can actually prevent wrongful conversion or separate use of marital property, and the frequency with which such conduct will occur, reinforce the conclusion that courts should deal with such problems at the definitional stage by reinclusion of the converted or wasted assets within the pool of marital property.[82]

C. *Source of Funds*

The most critical issue concerning the definition of marital property, and indeed, the equitable operation of the statute itself, is the interpretation of the phrase "acquired . . . during . . . the marriage."[83] Case law from other jurisdictions makes clear that there are basically two options available to courts confronted with this interpretive issue.[84] "Acquired" may be given its literal meaning, under which property is deemed to be acquired when title passes, regardless of the equity in the property at that time;[85] or "acquired" may be given a more flexible meaning, under which property is deemed to be acquired as it is actually paid for, regardless of the formalities of taking title.[86] Only the second

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"protect the spouse whose partner manages to convert marital assets before injunctive relief is applied for." *Mauser*, 75 N.C. App. at 119, 330 S.E.2d at 66.

81. *See, e.g.*, *Mauser*, 75 N.C. App. at 119, 330 S.E.2d at 66; Duke Power Co. v. City of High Point, 69 N.C. App. 335, 337, 317 S.E.2d 699, 700 (1984).

82. Dixon v. Dixon, 62 N.C. App. 744, 303 S.E.2d 606 (1983), is one reported case that has actually dealt with N.C. GEN. STAT. § 50-20(i) (Supp. 1985). The court of appeals dismissed the appeal of a wife against whom an injunction had been issued, holding that the purpose of the relief was only to preserve the status quo and that she had not shown that any "substantial right" would be adversely affected by granting such relief to the husband. *Dixon*, 62 N.C. App. at 745, 303 S.E.2d at 607.

83. N.C. GEN. STAT. § 50-20(b)(1) (Supp. 1985); *see also* Sharp, *supra* note 6, at 254-59 (discussing the need to focus on when acquisition occurs in classification-based states).

84. Sharp, *supra* note 6, at 258. The classic situation in which the issue is most likely to arise occurs when one spouse takes title to property, particularly a house, shortly before marriage. The mortgage is thereafter paid off, in whole or in part, with marital funds. The "transmutation" theory, which has been adopted in some community property states and in Illinois, can be regarded as a third option. *See id.* This theory does not, however, focus on the interpretation of the word "acquired." Instead, it results in the classification as marital of separate property that has been commingled with marital, and is based on the presumed intent of the parties to transmute the property to marital by a failure to treat it as separate. North Carolina has clearly rejected this theory. *See* McLeod v. McLeod, 74 N.C. App. 144, 156-57, 327 S.E.2d 910, 918, *cert. denied*, 314 N.C. 331, 333 S.E.2d 488 (1985); Wade v. Wade, 72 N.C App. 372, 381, 325 S.E.2d 260, 269 (1985). The transmutation theory, however, under which almost any degree of commingling, or even careless handling, can result in a reclassification of property, should be distinguished from the transmutation *result*. There are simply times when separate property, and especially separate funds, can become so mixed and commingled with marital assets that they cannot be traced out. North Carolina courts have thus far failed to draw the distinction between a "commingling" result, and the transmutation theory itself. *See infra* text accompanying note 136.

85. This is known as the "inception of title" theory, now on the wane even in community property states where it originated and was once common. W. DEFUNIAK & M. VAUGHAN, PRINCIPLES OF COMMUNITY PROPERTY § 64, at 130-32 (1971).

Missouri, until recently the only common-law state that had adopted this highly technical approach, has abandoned it in favor of the source of funds rule. *See* Hoffman v. Hoffman, 676 S.W.2d 817, 825 (Mo. 1984).

86. This has been labeled the "source of funds" approach. The doctrine is "premised on the realities of marital relationships, and on the proposition that it is fundamentally unfair to allow a

approach, which has become known as the "source of funds" approach, provides for a return on investment for both marital and separate contributions to the acquisition of property. This approach is thus considerably more compatible with partnership principles, and as a result, virtually all common-law classification based systems have adopted it.[87] Despite a rather awkward and still sometimes confusing start, it seems that North Carolina has followed suit. North Carolina has done so, however, in a fashion which demonstrates all too well that the source of funds approach is immensely easier to explain than to apply.[88]

The first really substantive decision dealing with the acquisition issue did not bode well. In *Turner v. Turner*[89] plaintiff-husband had refinanced his house one month before marriage. During the ensuing six years the marital estate had made improvements and repairs to the house, as well as mortgage payments.[90] The court of appeals held that the house "as such" could not be subject to equitable distribution. If, however, equity had been created during the marriage by improvements or payments contributed by the defendant-wife, then such equity might be marital. Absent any finding of what appeared to be direct contributions, the court observed that any equity derived from "a mere increase in value" could nonetheless be considered as a distributional factor.[91]

The clear and disturbing implication of *Turner* was that, at best, the defendant would be entitled only to reimbursement for her direct monetary contributions to the increased equity—a result that denies any return on investment and thus closely resembles the result reached under the inception of title theory in community property states.[92] However, subsequent cases have enunciated

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spouse to claim, upon divorce, that property is separate when the property was clearly regarded as marital throughout the marriage." Sharp, *supra* note 6, at 256. A somewhat different, and quite useful, way of conceptualizing its effect is to say that it defines "property" as equity, so that formal legal title does not control the ultimate classification of the asset. *See* Graham, *Using Formulas to Separate Marital and Nonmarital Property: A Policy Oriented Approach to the Division of Appreciated Property Upon Divorce*, 73 KY. L.J. 41, 53-54 (1984-85). For valuation purposes, moreover, North Carolina clearly equates property with equity. *See* Alexander v. Alexander, 68 N.C. App. 548, 550-51, 315 S.E.2d 772, 775 (1984) (defining net value as market value minus the amount of any encumbrance).

87. *See* Sharp, *supra* note 6, at 256; *see also supra* note 85 (noting that the "inception of title" theory is on the wane even in community property states). This widespread adoption of the principle obscures many of the significant variations in result that can be accommodated within a source of funds analysis. *See infra* notes 125-30.

88. *See generally* Graham, *supra* note 86 (discussing implications associated with the division of marital property in Kentucky).

89. 64 N.C. App. 342, 307 S.E.2d 407 (1983).

90. *Id.* at 343, 307 S.E.2d at 407. The trial court had not made findings on the value of the house, either before or after the marriage, or of the improvements.

91. *Id.* at 346, 307 S.E.2d at 409. On remand the court of appeals recommended that the trial court find the following facts:

> the date plaintiff bought the house, the price, amount paid down, the amount of the mortgage, his equity when they got married; the amount of the mortgage payments and the cost of the improvements . . .; the earnings of each party; her contributions to either the equity in the house or the family expenses . . . .

Id.

Whether or not the wife could claim any interest in her husband's stock purchased under a plan from his employer also depended on a finding of "her contributions, if any, to the purchase of the stock." *Id.*

92. *See* W. DEFUNIAK & M. VAUGHAN, *supra* note 85, at 133; *see also* Comment, *supra* note

the clear remedial and partnership policies underlying the statute and have thus considerably negated the precedential value of this aspect of *Turner*.[93]

Thus, *Wade v. Wade*[94] can properly be regarded as the first case to address the meaning of "acquired" at a substantive level. Plaintiff-husband in *Wade* had purchased a lot prior to marriage. During the eight-year marriage, the parties, using marital funds, had constructed a home on the lot.[95] The trial court awarded the house and lot to defendant-wife, apparently because the husband "had possession of most of the remaining marital property and had either hidden, sold, or otherwise disposed of it."[96] The husband appealed, contending that the property was separate because the land had been "acquired" before marriage and that the house was but an "improvement." The husband contended that this increase in value of separate property must, under North Carolina General Statute section 50-20(b)(2), retain its separate character.[97]

It should be noted that the issue in *Wade* was not presented within a "source of funds" versus "inception of title" context: the husband's argument was that the house was merely an increase in value of separate property.[98] It seems, however, that the more fundamental analytical issue presented by the *Wade* facts was *not* how to treat the increase in value of husband's allegedly separate property. Rather, the issue in *Wade* was whether such property should have been regarded as separate in the first instance. The significance of this distinction should not be overlooked.

If equity is equated with property,[99] then it is relatively easy to conceive of it as a "thing" that is acquired, at least in part, during the marriage, and it would therefore presumptively be classified as marital property.[100] The signifi-

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26 (inference of title when classifying marital home). Even some common-law property states have begun to move away from this inequitable result, however. *See In re* Marriage of Moore, 28 Cal. 3d 366, 618 P.2d 208, 168 Cal. Reptr. 662 (1980).

93. Although *Turner* has not been overruled, its classification implications have been ignored by other cases that have, consistently, reached contrary results. *See infra* notes 124-25 and accompanying text.

94. 72 N.C. App. 372, 325 S.E.2d 260 (1985).

95. *Id.* at 378, 325 S.E.2d at 267.

96. *Id.* at 382, 325 S.E.2d at 269. The lower court had found, however, that plaintiff had in his possession some $200,000 in marital property. There was no trial court discussion of the basis on which defendant was awarded less than half of this amount—the house and lot, together with a car awarded to her, had a value of roughly $80,000. Indeed, the trial court purported to have taken into consideration the husband's fraudulent conduct during discovery and trial in making an unequal division that nonetheless favored him. *Id.* at 375, 325 S.E.2d at 265. The court of appeals did note that it was "not clear" to it that this result was warranted. *Id.* at 376, 325 S.E.2d at 266.

97. *Id.* at 378, 325 S.E.2d at 267. A literal and extremely narrow interpretation of N.C. GEN. STAT. § 50-20(b)(2) (Supp. 1985) would have supported the husband's argument: "[t]he increase in value of separate property . . . shall be considered separate property."

98. *Wade*, 72 N.C. App. at 378, 325 S.E.2d at 267. It is unfortunate that North Carolina courts were not confronted, in this first instance, with a more straightforward and typical issue of whether to adopt the source of funds approach. The failure of the parties and the court to identify more precisely and analytically the issue in *Wade* has created a legacy of considerable confusion. *See infra* notes 116-21 and accompanying text.

99. *See supra* note 86. As noted therein, North Carolina does, in effect, define "property" according to its net, or equity, value. *See also* Little v. Little, 74 N.C. App. 12, 327 S.E.2d 283 (1985) (date of separation determines net market value of marital property); *Wade*, 72 N.C. App. at 376, 325 S.E.2d at 266 (court must use net value as opposed to fair market value).

100. The distinction between marital contributions that aid in the acquisition of property, and

cance of characterizing the equity as *property* that the marital estate had acquired is that the marital unit would then be entitled to share, in direct proportion to its investment, in any capital appreciation of the asset it had partially acquired.[101] If, on the other hand, the marital equity in the separate property is characterized merely as an increase in value of that property, the confrontation with section 50-20(b)(2) is inevitable. The bald language of that section states that increases in value of separate property shall be separate.[102] In those states that classify increases in value of certain types of separate property as marital property in the first instance, of course, the distinction may not be as significant: the contributing estate receives a return on its investment, regardless of whether its contribution to equity is characterized as an "increase in value" or as "property" acquired during the marriage.[103] But in North Carolina the distinction is critical.

However, the *Wade* court never drew this distinction clearly, if indeed it drew it at all. As a result, the opinion is somewhat confusing. The *Wade* opinion nonetheless warrants a careful analysis. The court first held that the house and land must be considered as a single asset. It went on, however, to reject the husband's argument that the asset should be considered separate property, but it did so in language that clearly implied it had accepted his "increase in value" characterization:[104]

> [I]n light of the evils sought to be remedied and the objectives to be attained . . . we interpret . . . [section 50-20(b)(2)] as referring only to passive appreciation of separate property, such as that due to inflation, and not to active appreciation resulting from the contributions, monetary or otherwise, by one or both of the spouses.[105]

The court realized that a contrary result would "create [an] incentive for a sophisticated spouse to divert marital funds into improving his or her separate property thereby depriving the other spouse of any possible return of the marital

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those that merely increase its value, is, quite obviously, not always easy to draw. *See infra* text accompanying notes 218-22. In many instances, however, as with mortgage payments, it is relatively clear.

101. *See* W. REPPY & C. SAMUELS, COMMUNITY PROPERTY IN THE UNITED STATES 81 (2d ed. 1982); Sharp, *supra* note 6, at 256-57. In many other common-law states this same result is obtained, regardless of whether the marital equity is viewed as property or an increase in value, because increases in value are usually regarded as marital. *See, e.g., In re* Marriage of Moore, 28 Cal. 3d 366, 618 P.2d 208, 168 Cal. Reptr. 662 (1980); Brandenberg v. Brandenberg, 617 S.W.2d 871 (Ky. Ct. App. 1981); Harper v. Harper, 294 Md. 54, 448 A.2d 916 (1982). Even here the marital estate does not receive credit for the taxes and interest it paid as it acquired equity in an asset. The former payments would appear to be regarded as more in the nature of "rent." For a discussion of the various methods that may be employed under a source of funds approach, see *infra* notes 128-29.

102. N.C. GEN. STAT. § 50-20(b)(2) (Supp. 1985). This was, at least initially, the approach the *Wade* court took. *See infra* text accompanying notes 193-96.

103. *See* L. GOLDEN, *supra* note 1, § 5.38; Sharp, *supra* note 6, at 260-61.

104. "The appreciation of the real property in the present case was clearly the active type as it resulted from the parties' contributions during marriage." *Wade*, 72 N.C. App. at 379, 325 S.E.2d at 268.

105. *Id.* The court relied heavily, if not solely, on partnership principles, the remedial nature of the statute, and the policy of repayment of contribution in reaching this result. *Id.* at 379-80, 325 S.E.2d at 268.

investment upon the dissolution of the marriage."[106]

The active/passive distinction initially drawn by the *Wade* court is in fact a refinement of the source of funds "acquisition" analysis. It is well established in those states that classify increases in value of some types of separate property as separate, and it is particularly useful with closely held corporations.[107] The active/passive distinction is designed to ensure that marital contributions to the appreciation of separate property are credited to the marital estate. But in *Wade* the court of appeals apparently adopted the active/passive analysis with alleged increases in value before it had determined whether such an "increase in value" characterization was appropriate, and before it had adopted, or even discussed, source of funds as an acquisitional doctrine.[108]

Immediately thereafter, however, the court approached the same problem from the latter point of view. The court noted that "a dynamic rather than static interpretation of the term 'acquired' . . . will best serve to prevent inequity," and concluded that "acquisition must be recognized as the ongoing process of making payment for property or contributing to the marital estate rather than being fixed on the date that legal title to property is obtained."[109] This may result, the court realized, in a dual classification[110] of property as part marital and part separate, but such an effect, it concluded, is consonant with both partnership and repayment of contribution principles, because it ensures that "both the separate and marital estates receive a proportionate and fair return on its investment."[111]

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106. *Id.* at 380, 325 S.E.2d at 268.

107. For a discussion of North Carolina cases that have applied this approach to closely held corporations, see *infra* notes 197-218 and accompanying text. *See also* L. GOLDEN, *supra* note 1, § 5.37 (discussing various methods used to resolve classification problems of appreciated separate property); Sharp, *supra* note 6, at 260-61 (discussing approaches to allocate increases in value in classification-based states). It is also an established distinction in many community property states, where the term "natural enhancement" is often used as a synonym for passive increases. *See, e.g.*, Cockrill v. Cockrill, 124 Ariz. 50, 601 P.2d 1334 (1979); Johnson v. Johnson, 89 Nev. 244, 510 P.2d 625 (1973). North Carolina appears to be unique in classifying increases in value of all separate property as separate.

108. In general, the marital estate's return on investment is limited, with increases in value, to whatever "active" contributions it can prove it made. Whether or not the "actively" appreciated marital estate could in turn reap the benefits of any "passive" appreciation that accrued to *its* marital share is an issue that has been raised by North Carolina cases. *See infra* notes 120 & 206.

In a more recent case, Nix v. Nix, 80 N.C. App. 110, 341 S.E.2d 116 (1986), the court of appeals seems almost to have identified the source of funds approach with, and *limited it to*, this active/passive refinement. The court observed that "property can have a dual nature and can be classified as part separate and part marital. This approach takes into account the active appreciation of separate property which often results from contributions made by one or both spouses." *Id.* at 113, 341 S.E.2d at 118. It is clear, moreover, that no case has thus far applied the source of funds doctrine in its classic, *acquisitional* sense. Indeed, in *Nix* the parties had each brought separate property into the marriage, had improved those properties, mortgaged and sold part of them, and acquired new assets. *Id.* at 111-12, 341 S.E.2d at 117-18. Nothing in the decision, however, indicates that the necessary facts were found (amounts of mortgages paid off with marital funds, for example) on which a classic source of funds analysis *could* have been made.

109. *Wade*, 72 N.C. App. at 380, 325 S.E.2d at 268-69.

110. A "unitary" concept of property, by contrast, mandates that property be either marital or separate. *See In re* Marriage of Smith, 86 Ill. 2d 518, 427 N.E.2d 1239 (1981). Thus, marital and separate shares cannot be traced out of property with a contrary classification.

111. *Wade*, 72 N.C. App. at 382, 325 S.E.2d at 269. The court went on to hold that, given the circumstances of the case, the trial court had possessed the authority to order the house and lot to be

Thus, the *Wade* court began by drawing an active/passive distinction with increases in value of "separate" property, but apparently ended with the conclusion that the equity at issue was marital because it was property "acquired" during the marriage. The court failed to realize, however, that the latter result usually obviates the need for the former; once property is determined *itself* to partake of a dual nature, each estate automatically, and proportionately, should share in any increase in value, regardless of whether that increase is traced to active or passive sources.[112]

The *Wade* court also failed to follow through with the logic of its own "acquisition" result by suggesting that the separate estate of the husband should be entitled to share the benefits of any increase in value of the property.[113] This "reimbursement only" result is, of course, common with unitary property jurisdictions, and with transmutation principles.[114] However, it is blatantly inconsistent with a source of funds analysis, which, as North Carolina courts have

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transferred to the wife. *Id.* at 382-83, 325 S.E.2d at 269-70. In doing so, it seemed to indicate clearly that it had approved a transfer of the husband's *separate* property—the land surrounding the house—to the wife. This apparent invasion of separate property, however, was permissible *only* because the house was the "only asset" that the husband had not successfully, if wrongfully, shielded from distribution. The "invasion" problem might have been avoided altogether had the court reincluded the value of converted marital assets into the marital pool and merely approved the lower court's alternative distributive award of $80,000 to the wife. *Id; see infra* text accompanying note 358. Despite the court's observation that the husband was entitled to reimbursement for his separate property contribution, moreover, it is unclear if the ultimate award of the house and lot to the wife was subject to any such right to reimbursement. A denial, on equitable grounds, of any reimbursement right to the husband would seem to have been fully justified. *See infra* text accompanying note 329.

112. *See also* Nix v. Nix, 80 N.C. App. 110, 341 S.E.2d 116 (1986) (upholding trial court's distribution of marital property including a $4000 credit to husband when both husband and wife contributed substantially to increase in value of the separate property of each other); *supra* note 108 (discussing limits placed on marital estate's return on investment). Professor Golden notes, by way of example, that in source of funds states "improvements made during the marriage on . . . separate property are deemed to be discrete elements of property acquired during the marriage." L. GOLDEN, *supra* note 1, § 5.38, at 45 (Supp 1986). For a good illustration of this point, see Hall v. Hall, 462 A.2d 1179 (Me. 1983), in which the court held that improvements to separate property should not be excluded as an "increase in value," but instead should constitute an acquisition of property during the marriage. *Id.* at 1182. At the risk of belaboring the point, the distinction may be critical in North Carolina, because it may be that the marital estate can share in such passive increases in value only if it is deemed to have *acquired* the property, at least in part. The court in *Wade*, however, apparently skirted this problem, because it concluded that there had been no passive increase in value—a result that hardly seems realistic given the rate of inflation during this eight-year marriage. *Wade*, 72 N.C. App. at 379, 325 S.E.2d at 268.

113. The *Wade* court noted that plaintiff would be entitled to "a return of, or reimbursement or credit for," his separate property contribution to the marital property. *Wade*, 72 N.C. App. at 382, 325 S.E.2d at 269. It also observed that "[t]hat part of the asset which is separate in character should be returned in kind to the person contributing it so far as it is practical." *Id.* at 383, 325 S.E.2d at 270. An in kind return of property would mean, of course, that the property would share in any passive increases in value. But as a practical matter, most dual property—as in *Wade*—is divisible only by apportioning shares or values therein. It must be emphasized, moreover, that mere reimbursement means that the contributing estate has made a nonproductive investment in the other estate. In effect, it has made an "interest free loan." *See* W. REPPY & C. SAMUELS, *supra* note 101, at 107.

114. W. DEFUNIAK & M. VAUGHN, *supra* note 85, at 133-34. Such reimbursement does not include a portion of the increased value of the property. The possibilities for unfairness inherent in such an approach have led many community property states to abandon it in favor of a source of funds analysis. *See, e.g.*, Cockrill v. Cockrill, 124 Ariz. 50, 601 P.2d 1334 (1979); *In re* Marriage of Moore, 28 Cal. 3d 366, 618 P.2d 208, 168 Cal. Rptr. 662 (1980); Johnson v. Johnson, 89 Nev. 244, 510 P.2d 625 (1973).

realized at least in the abstract, mandates a fair and proportionate "return on investment" for each estate.[115] *Wade* thus created what amounts to double-layered confusion: first, by failing to distinguish analytically between an "acquisitional" and an "active/passive" application of the source of funds approach; and second, by failing to distinguish either of those differing investment return results from a reimbursement result. Not surprisingly, this has led to similar confusion in subsequent cases.

In particular, the confusion between a reimbursement and fair return result is evident in other cases.[116] In *Talent v. Talent*,[117] for example, the court observed, almost in passing, that the wife was "entitled" to "reimbursement" for 1,500 dollars of separate property that had been used to acquire marital property.[118] In *Lawrence v. Lawrence*,[119] on the other hand, the court seemed to reach a "reimbursement only" result with regard to the *marital* portion of dual property.[120] The reimbursement results of these cases are inconsistent not only

115. Smith v. Smith, 314 N.C. 80, 331 S.E.2d 682 (1985); Wade v. Wade, 72 N.C. App. 372, 325 S.E.2d 260 (1985); Hinton v. Hinton, 70 N.C. App. 665, 321 S.E.2d 161 (1984). It should be noted that a "reimbursement only" result is inconsistent with both active/passive distinctions for increases in value *and* a source of funds acquisitional analysis.

116. *See* McLeod v. McLeod, 74 N.C. App. 144, 327 S.E.2d 910, *cert. denied*, 314 N.C. 331, 333 S.E.2d 488 (1985); Phillips v. Phillips, 73 N.C. App. 68, 326 S.E.2d 57 (1985). For a discussion of the *McLeod* and *Phillips* cases, see *infra* notes 197-218 and accompanying text. The earlier case of Turner v. Turner, 64 N.C. App. 342, 307 S.E.2d 407 (1983), discussed *supra* text accompanying notes 89-93, had apparently reached similar results. A later case, Cable v. Cable, 76 N.C. App. 134, 331 S.E.2d 765 (1985), held simply that "equity which accrued during a marriage [in a house defendant husband had bought just before marriage] could be marital property" and that the trial court had "erred as a matter of law in concluding that plaintiff had no interest" in defendant's property. *Id.* at 137, 331 S.E.2d at 767.

117. 76 N.C. App. 545, 334 S.E.2d 256 (1985).

118. *Id.* at 553, 334 S.E.2d at 262. This was not, however, an issue on appeal.

119. 75 N.C. App. 592, 331 S.E.2d 186 (1985).

120. *See id.* at 595-96, 331 S.E.2d at 188; *supra* note 111. It was the husband's labor in *Lawrence* that had been contributed to making improvements in a house his wife had owned before marriage. In language that illustrates perfectly the difficulties courts are having in this area, the court held:

> That part of the real property consisting of the unimproved property owned by defendant prior to marriage should be characterized as separate and that part of the property consisting of the additions, alterations and repairs provided *during marriage* should be considered marital in nature. As the marital estate is entitled to a return of its investment, defendant because of her contribution of separate property is entitled to a return of, or reimbursement or credit for, that contribution.

Lawrence, 75 N.C. App. at 595-96, 331 S.E.2d at 188. Earlier in its opinion, however, the court had noted that "the marital estate is entitled to a proportionate return of its investment." *Id.* at 595, 331 S.E.2d at 188. *Lawrence* appears to be, in fact, a rather good example of a straightforward "increase in value" case, because there was no indication that any mortgage payments had been used to acquire any additional equity in the house. Much confusion could have been avoided had the lower court been instructed to find: (1) the value of wife's separate property at the date of the marriage; (2) its value at the date of separation; and (3) the proportion of the difference between the two amounts that was attributable to the husband's labor. If, on the other hand, the marital estate had contributed both labor—resulting in an increase in value—and mortgage payments—resulting in an acquisition of marital property—the court might have been faced with application of both types of source of funds computation. In Woosnam v. Woosnam, 587 S.W.2d 262 (Ky. Ct. App. 1979), the court dealt with a similar issue by requiring that the value of the permanent improvements attributable to marital contributions be subtracted from the value of the home *before* application of a source of funds formula to determine ownership shares in the dual property. *Id.* at 264.

It should be noted that the contribution of labor to separate property apparently is not deemed to result in an acquisition of a portion of the separate property in most states. If, however, the marital estate makes a cash contribution to separate property, the issue has arisen in a few states

with the fundamental premise of the source of funds doctrine and the partnership ideal, but with one another as well. Thus, arguably the only realistic observation that can be drawn is that these decisions stand only for the proposition that North Carolina courts understandably are having difficulties working through the analytical and practical implications of the source of funds analysis.[121]

Despite this confusion, both in analysis and result, however, it is reasonable to suggest that North Carolina courts are treating marital contributions to separate property as *property acquired* during the marriage. And regardless of what it is probably fair to characterize as the aberrant reimbursement results of some cases, it is also clear that property thus acquired entitles both estates to share, in proportion to their investments, in any increase in value.[122] *McLeod v. McLeod*,[123] probably the most significant case thus far on the new statute, clearly reinforces the latter conclusion: source of funds, the *McLeod* court observed, albeit only in dicta, "would dictate that each party retain as separate property the amount he or she contributed to the down payment, plus the increase on that investment due to passive appreciation."[124]

Moreover, both of these conclusions are essential to what has become the "first principle" of the partnership ideal in North Carolina—that equitable distribution must ensure that each estate receives a fair and proportionate return on its investment. This return on investment, both as a matter of logic and equity, must include proportionate sharing of both active and passive increases in value, when assets have been *acquired* by both estates.

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whether such contribution should be treated as an increase in value or as an acquisition of a portion of the separate property. *See supra* note 112. Although it would be unjust to say that this "call" between increase in value and acquisition is arbitrary, there appears to be no real "test" employed by courts to make the distinction. *See* cases cited *infra* note 222. With a one-time contribution of separate funds, and thus a one-time "acquisition," the computation is not difficult. If, for example, the husband in *Lawrence* had contributed $10,000 in marital funds to build an addition to the wife's house in year one of the marriage, when the house had a net value of $100,000, the marital estate should be entitled to a proportionate share of the full increase in value of the house. For a discussion of the formulas to determine such ownership interests, see *infra* note 128. If, on the other hand, marital contributions totaling $10,000 had been made throughout the marriage, an "acquisitional" analysis might mean that the underlying ownership interests in the property, and the proportional increases in value attributable to each, would shift as each contribution was made. This can result in enormously complicated financial analyses that must be made on a year-by-year, or sometimes even month-by-month, basis. *See* W. REPPY & C. SAMUELS, *supra* note 101, at 82, 142. For a discussion of the possibility that North Carolina cases have suggested a similar approach, see *infra* note 206.

121. The failure of these decisions to ensure a proportionate return on investment for each estate may also be related to the complexity of the facts and issues presented on appeal, particularly in *Wade* and *Talent*. In *Wade*, moreover, the court of appeals clearly shared the trial court's disdain for defendant's behavior. *Wade*, 72 N.C. App. at 382, 325 S.E.2d at 269.

122. Professor Golden, for example, classifies North Carolina as one of the jurisdictions that treats contributions to the separate estate as "discrete elements of property acquired during the marriage." L. GOLDEN, *supra* note 1, § 5.38, at 45 (Supp. 1986).

123. 74 N.C. App. 144, 327 S.E.2d 910, *cert. denied*, 314 N.C. 331, 333 S.E.2d 488 (1985).

124. *Id.* at 154, 327 S.E.2d at 916. The court went on, however, to create a presumption of gift with entireties property. *See id.* at 155, 327 S.E.2d at 917; *infra* text accompanying notes 170-72. A source of funds analysis would be appropriate only if the presumption were rebutted. *McLeod*, 74 N.C. App. at 154, 327 S.E.2d at 916-17. Within the context of a closely held corporation, moreover, even *McLeod* evidences some of the *Wade* confusion between acquisition and increases in value of property. *See infra* text accompanying note 206.

An appreciation of the difference in treatment between marital contributions that aid in the acquisition of property—which then takes on a dual nature—and those that aid in the appreciation of separate property is critical to an understanding of the source of funds approach. At the same time, it must be emphasized that a source of funds analysis cannot, and must not, be reduced to a kind of dichotomous choice between these two results. This is true for several reasons. First, as *Wade* itself illustrates, the apparent neatness of the analytical distinction between acquisition and increase in value often disappears at a practical level. Spouses do not conduct their economic lives to fit distributional theories. Whether a marital contribution should be regarded as having an acquisitional or increase in value result depends on a great variety of factors—the nature of the asset, the size and form of the contribution, and the distributive result that would be obtained.[125] Guidelines for drawing the distinction will undoubtedly be created as case law develops in this area. However, it is unlikely that the distinction will ever be drawn with great precision.[126]

Second, drawing the distinction between increase in value and acquisitional results is only the first step in a still more complicated process that, in either event, will not yield easy or wholly predictable results. With an increase in value approach, for example, the inherently imprecise active/passive distinction must still be drawn.[127] With an acquisitional analysis, various computational formulas have been developed in other states that may provide useful tools for estimating marital and separate shares in a dual property asset.[128] It must be

125. Lawrence v. Lawrence, 75 N.C. App. 592, 331 S.E.2d 186 (1985), for example, would tend to indicate that contributions other than cash or cash equivalents can result in active increases in the value of separate property. *See supra* note 120.

126. *See supra* note 112.

127. North Carolina courts have, however, begun to refine the elements of an active/passive analysis. *See infra* notes 203-18 and accompanying text.

128. *See* Graham, *supra* note 86, at 47-51, 61-62. My own observation in an earlier article that the source of funds doctrine should be "simple to apply," Sharp, *supra* note 6, at 257, is perhaps indicative of the kind of precipitious conclusions that can be drawn by a novice who underestimates the complexities of the area. Clearly the statement is erroneous.

It must be emphasized that there is no single formula, and certainly no single "correct" formula, that is used to compute separate and marital shares under a source of funds analysis. Although *Wade* cited to one formula with approval, *Wade*, 72 N.C. App. at 382, 325 S.E.2d at 269, North Carolina courts have not been confronted with the issue of which formula, or formulas, might be applied. However, a rather simplified example can be used to illustrate the differences between two major approaches using the following facts. Assume that the wife contributed $5,000 of separate property to buy a house one week before marriage. The house had a value of $20,000 at that time and the wife took out a $15,000 mortgage. At the date of divorce, the mortgage has been reduced—by marital funds—by $5,000 and the house has increased in value to $30,000. Under the formula used by the Maine Supreme Court in Tibbetts v. Tibbetts, 406 A.2d 70 (Me. 1979), and by the Kentucky Court of Appeals in Robinson v. Robinson, 569 S.W.2d 178 (Ky. Ct. App. 1978), the separate property share of the home at the date of divorce is determined by the percentage of ownership the separate property contribution represented to the *value* of the asset *at the date of acquisition*. Thus, the calculation is as follows:

$$\frac{\text{separate property (\$5,000)}}{\text{fmv, date of marriage (\$20,000)}} = .25$$

The separate property proportion is then determined by multiplying this 25% by the fair market value of the house at the date of divorce:

$30,000 x .25 = $7,500 (separate property value)

The marital share is thus $22,500, but that figure must in turn be reduced by the remaining indebted-

emphasized, however, that there are several different types of formulas, all of which have certain disadvantages, and that no one formula can produce equitable results in all instances.[129] Rigid reliance on formulas, therefore, would appear to be inconsistent with the general equitable goals of the statute.

Last, as North Carolina courts arguably have already suggested, the acquisitional and increase in value approaches are not necessarily mutually exclusive.[130] There may be some instances in which an equitable result can be obtained only by application of both types of analysis to determine proportionate shares in a single asset. The equitable principles that underlie the source of funds approach certainly do not preclude such a result.

In summary, source of funds is a complex but very flexible principle that allows courts to recognize marital and separate ownership interests in a single property,[131] to compensate for separate contributions to marital property—or marital contributions to separate property,[132] to proportion ownership interests in increase in value of separate property depending on whether such increases were based on passive or active appreciation factors,[133] and to reclassify as mari-

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ness of $10,000, so that the net value of the marital property share is $12,500 versus $7,500 as the separate property share.

On the other hand, if the separate property share is determined with reference to the proportion of *total equity* that it represents—the approach approved by Kentucky in Brandenburg v. Brandenburg, 617 S.W.2d 871 (Ky. Ct. App. 1981) (overruling *Robinson* only insofar as the latter case noted in dicta that nonmonetary contributions might result in the recharacterization of equity in property as marital), and by Maryland in Harper v. Harper, 294 Md. 54, 448 A.2d 916 (1982), a quite different result is obtained. Under this approach, the computation proceeds as follows, using the same facts as set forth previously:

$$\frac{\text{separate property (\$5,000)}}{\text{total contribution to equity (\$10,000)}} \times \begin{array}{l}\text{equity (\$20,000)}\\ \text{(fmv at date of}\\ \text{divorce)}\end{array}$$

Thus, the separate property value is $10,000 under this approach—a result that differs substantially from that reached under the *Tibbetts/Robinson* formula.

The Kentucky experience with formulas is discussed in detail in Graham, *supra* note 86, at 51. It should be noted, however, that even judicially approved formulas are not mandatory. *See* Brandenburg v. Brandenburg, 617 S.W.2d 871, 873 (Ky. Ct. App. 1981).

129. Some of the formulas, for example, tend to leverage the separate estate. *See* Graham, *supra* note 86, at 51. None, moreover, factor in the value of contributions based upon the time when such contributions were made: mortgage payment number 10 is treated as having the same acquisitional result as payment number 120. The formulas also do not credit the contributing estate with payment of interest, taxes, or insurance. *See supra* note 113.

A formula that yields an apparently equitable result in one instance, moreover, may yield a quite inequitable result in another. This is particularly true with the *Tibbetts* formula, discussed *supra* note 128, by which the separate property proportion remains fixed, regardless of the length of the marriage or the extent of the increase in value of the asset. If, for example, the wife had contributed $18,000 to the $20,000 purchase price of the home prior to marriage, and the home had increased in value during 30 years of marriage to $100,000, her separate property portion would be $90,000. *But see infra* note 130 (discussing the treatment to be given the wife's separate property portion).

130. *See infra* note 206. In the *Tibbetts* variation discussed *supra* note 128, for example, the wife's $90,000 separate property portion could then itself become subject to an active/passive analysis to determine what portion of that increase in value should be attributed to the marital estate.

131. *See* Talent v. Talent, 76 N.C. App. 545, 334 S.E.2d 256 (1985); Cable v. Cable, 76 N.C. App. 134, 331 S.E.2d 765 (1985); Wade v. Wade, 72 N.C. App. 372, 325 S.E.2d 260 (1985).

132. *See* Talent v. Talent, 76 N.C. App. 545, 334 S.E.2d 256 (1985); Lawrence v. Lawrence, 75 N.C. App. 592, 331 S.E.2d 186 (1985).

133. *See* McLeod v. McLeod, 74 N.C. App. 144, 327 S.E.2d 910, *cert. denied*, 314 N.C. 331, 333

tal any separate property that was converted from marital funds.[134] The source of funds principle thus creates broad opportunities for ensuring an appropriate return of investment for each estate and for the ultimate preservation of separate property interests, and thereby accommodates two fundamental principles that underlie the statute. The difficulty of drawing the distinctions among these various uses of the doctrine in some cases should not obscure the importance of doing so.

D. *Tracing*

Application of the source of funds doctrine depends on the ability to trace the contribution of property from either a marital or separate source to an asset with a contrary classification. This will sometimes involve an attempt to trace out marital property contributions from separate property, particularly when the latter has increased in value.[135] Given the presumption that all property acquired during the marriage is marital, however, this "tracing out" burden will usually be imposed on a party claiming a separate interest in marital property. If the effort to trace does not produce evidence sufficient to rebut the presumption, no separate property interest will be recognized.[136]

The demands of tracing can vary enormously, depending largely on the nature of the contributed asset and the amount of time that has passed since the contribution. Marital effort or talent that increases the value of separate property, for instance, usually is not susceptible to precise evaluation, although the presumption that the parties contributed equally to such increases does provide a reasonably definite starting point for such computation.[137] When a party seeks to establish a discrete cash contribution to an asset, in order to establish either a marital or a separate claim thereto, evidentiary requirements become much more specific.

In practice even specific tracing requirements may be easy to meet, particularly when the asset in question is real or personal property that was acquired before marriage or that was a gift from a third party.[138] Similiarly, the burdens

S.E.2d 448 (1985); Phillips v. Phillips, 73 N.C. App. 68, 326 S.E.2d 57 (1985). This application of the doctrine is particularly appropriate with closely held corporations or other individually owned businesses, and is discussed in more detail *infra* text accompanying notes 197-208.

134. *See* McManus v. McManus, 76 N.C. App. 588, 334 S.E.2d 270 (1985); Talent v. Talent, 76 N.C. App. 545, 334 S.E.2d 256 (1985); Phillips v. Phillips, 73 N.C. App. 68, 326 S.E.2d 57 (1985); Wilson v. Wilson, 73 N.C. App. 96, 325 S.E.2d 668 (1985).

135. *See infra* text accompanying notes 197-208 (discussing closely held corporations).

136. Loeb v. Loeb, 72 N.C. App. 205, 212-13, 324 S.E.2d 33, 39, *cert. denied*, 313 N.C. 508, 329 S.E.2d 393 (1985). It should be emphasized, however, that this result in no way evidences an application of the transmutation theory. Transmutation creates an indivisible property asset from which a party is not even allowed to *attempt* to trace separate contributions. The "unitary" interest in the property in *Loeb*, by way of contrast, derived not simply from the fact the property had been commingled, but rather from the wife's failure to trace her separate interest. *Id.* at 212, 324 S.E.2d at 39; *see also* McManus v. McManus, 76 N.C. App. 588, 591-93, 334 S.E.2d 270, 272-73 (1985), in which the husband was unable to present any evidence other than his own testimony, which the trial court did not find credible, that certain stocks had been a gift from his father.

137. Smith v. Smith, 314 N.C. 80, 87, 331 S.E.2d 682, 687 (1985); *see also Loeb*, 72 N.C. App. at 212, 324 S.E.2d at 39 (funds deposited in joint bank account could be separate property if traceable).

138. *See, e.g.*, Little v. Little, 74 N.C. App. 12, 327 S.E.2d 283 (1985). It is this aspect of the

of tracing are eased when the parties have clearly treated an asset as the separate property of one or the other. To the degree that contributed property lacks readily identifiable features or that the parties themselves treated the property in such a fashion that any "separate" intention was obscured, however, tracing may become difficult indeed. This is particularly well demonstrated with cash, a highly fungible and easily commingled asset.

As case law has made clear, the first step in attempting to trace out, for example, a separate cash contribution to a marital asset, is to establish the specific amount and source of the alleged contribution.[139] That amount must then be traced to a specific marital property use or acquisition, a burden that can be almost impossible to meet in some circumstances.[140] The situation can become even more complex when dual nature property is exchanged, frequently more than once, for other property. Indeed, there clearly comes a point when Gordian knots of property simply cannot, as a practical matter, and should not, as a matter of policy, be untied.[141] Moreover, courts should not hesitate to reach this result on the grounds that North Carolina has rejected the transmutation approach.[142] Failure to trace may duplicate a transmutation result but the underlying premises by which a court reaches such a result are entirely distinct.

E. *Conclusion*

Significant analytical and practical problems associated with the interpretation and definition of marital property in North Carolina remain unresolved. The need to enunciate more precisely the distinction between application of

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source of funds approach that has led to the criticism that it undermines the very partnership principles it purports to symbolize, by encouraging spouses, in effect, to "keep books" on their separate and marital contributions. In Turley v. Turley, 562 S.W.2d 665 (Ky. Ct. App. 1978), for example, the court observed that "[i]t does not bode well for the institution of marriage if each partner must keep in the back of his mind the possible advantage to be obtained by keeping up with and being able to trace every penny brought into the marriage." *Id.* at 669.

139. In Loeb v. Loeb, 72 N.C. App. 205, 324 S.E.2d 33, *cert. denied*, 313 N.C. 508, 329 S.E.2d 393 (1985), for example, the wife was unable to prove either the amount or the value of cash gifts from her mother. The gifts, clearly separate property initially, had been deposited in a joint account, but without proof of their value, they could not be traced out. *Id.* at 212-13, 324 S.E.2d at 39-40.

140. Brown v. Brown, 72 N.C. App. 332, 324 S.E.2d 287 (1985), is a very interesting case in this context. In *Brown* the husband was able to trace $4,000 in a joint account to separately acquired funds; the court reasoned that because the amount of money in the account had never fallen below $4,000, that amount had remained separate property. *Id.* at 335, 324 S.E.2d at 289. One could infer from this perhaps that if the account had fallen below that sum, the husband would not have been able to trace out the full $4,000 as separate property. For further discussion of whether or not he might be deemed to have made a gift, see *infra* note 175 and accompanying text. It is important to note that funds deposited in a joint account are not presumed to be a gift to the other spouse in North Carolina. *See Brown*, 72 N.C. App. at 336, 324 S.E.2d at 289; *see also* Manes v. Harrison-Manes, 79 N.C. App. 170, 338 S.E.2d 815 (1986) (jointly held personal property acquired in exchange for separate property does not create presumption of gift).

The *Brown* approach has been adopted in other states. *See, e.g.*, Allen v. Allen, 584 S.W.2d 599, 600 (Ky. Ct. App. 1979) ("We think the requirement of tracing should be fulfilled . . . when it is shown that nonmarital funds were deposited and commingled with marital funds and that the balance of the account was never reduced below the amount of the nonmarital funds deposited.").

141. At a minimum, it would seem reasonable to suggest that fairly strict standards for tracing be required for separate property that has been blended with, and treated as, marital property over a period of years.

142. *See supra* note 84.

source of funds principles to property that is jointly acquired during marriage, and to separate property which actively appreciates in value, remains acute. Even in this area, however, the groundwork has been laid for ensuring that both marital and separate estates receive a fair and proportionate return on their investments.

Moreover, North Carolina courts have resolved a remarkable number of significant issues, and they have done so in a manner consistent with the remedial purposes and partnership principles embodied in the statute. The presumption of marital property, adoption of the source of funds theory, the active/passive distinction, and the flexible definitions given such terms as "presently owned" and "acquired after separation"—all bespeak a laudable judicial effort to implement the equitable goals of the statute. These efforts are especially noteworthy in view of the statute's radical departure from previous law, and they are particularly critical in view of the statute's otherwise broad definition of separate property.

IV. SEPARATE PROPERTY ISSUES

A. *Property Acquired Before Marriage*

Subsection (b)(2) of the equitable distribution statute defines seven different types of marital property in language that is often quite cumbersome and certainly very expansive.[143] Fortunately, North Carolina courts have recognized that a restrained interpretation of this section is critical to any meaningful implementation of the overriding equitable and remedial purposes of the statute.

In common with most other classification-based jurisdictions, North Carolina excepts from the definition of marital property "all real and personal property acquired before marriage."[144] As previously discussed, however, adoption of the source of funds doctrine has greatly mitigated what would otherwise have been very harsh results from a literal interpretation of this language.[145] Thus, only property that is both legally and equitably acquired prior to marriage will

143. N.C. GEN. STAT. § 50-20(b)(2) (Supp. 1985) provides:

> "Separate property" means all real and personal property acquired by a spouse before marriage or acquired by a spouse by bequest, devise, descent, or gift during the course of the marriage. However, property acquired by gift from the other spouse during the course of the marriage shall be considered separate property only if such an intention is stated in the conveyance. Property acquired in exchange for separate property shall remain separate property regardless of whether the title is in the name of the husband or wife or both and shall not be considered to be marital property unless a contrary intention is expressly stated in the conveyance. The increase in value of separate property and the income derived from separate property shall be considered separate property. All professional licenses and business licenses which would terminate on transfer shall be considered separate property. The expectation of nonvested pension, retirement, or other deferred compensation rights shall be considered separate property.

144. *Id.* § 50-20(b)(1).

145. *See supra* text accompanying note 109. In "all property" jurisdictions, property owned by either spouse, regardless of its acquisition date, is subject to equitable distribution. Sharp, *supra* note 6, at 249. These states include Connecticut, Hawaii, Indiana, Kansas, Massachusetts, Michigan, Nebraska, New Hampshire, North Dakota, Oregon, South Dakota, Vermont, and Wyoming. Several of these states nonetheless consider the original source of the property as a distributional factor. *See, e.g.*, IND. CODE ANN. § 31-1-11.5-11(b) (Burns 1980).

be classified as separate property under this portion of the statute, while property that has a "dual" nature will, at least in part, be subject to distribution.[146]

Interesting issues have arisen in other states concerning the classification of property acquired in contemplation of marriage, or property acquired while the parties were living together. The traditional rule is that the meretricious nature of the relationship precludes the recognition of any legal or equitable rights arising therefrom whether or not the parties subsequently marry. Increasingly, however, some courts have, depending on the circumstances, been willing to treat such property as marital.[147] The use of the singular article in the definition of separate property, "acquired by *a* spouse before marriage," arguably suggests that North Carolina might be willing to recognize equitable rights in property that had been jointly acquired by the parties prior to marriage.[148] Moreover, there is some recent evidence that the North Carolina courts are prepared to recognize limited rights between unmarried cohabitants.[149] But on the whole it remains unlikely that North Carolina will follow the course sketched out by what is still a minority of other states. Whatever rights cohabitants possess in property acquired by either or both will probably continue to be determined by common law, not equitable distribution principles.

B. *Gifts and Exchanges*

Issues raised by the gift provisions of the separate property section of the statute, and particularly those issues raised by the relationship between the gift and exchange provisions, are considerably more complex. Like virtually all other classification-based states, North Carolina defines as separate "all real and personal property . . . acquired by a spouse by bequest, devise, descent or gift during the course of the marriage."[150]

In general, inherited property and gifts from third parties present few difficulties beyond those that are associated with tracing.[151] Gifts to a spouse are clearly the separate property of that spouse, and joint gifts or devises are pre-

146. *See supra* notes 109-11 and accompanying text.

147. *See, e.g.*, Stallings v. Stallings, 75 Ill. App. 3d 96, 393 N.E.2d 1065 (1979); Bashore v. Bashore, 685 S.W.2d 579 (Mo. Ct. App. 1985).

148. *See* N.C. GEN. STAT. § 50-20(b)(2) (Supp. 1985) (emphasis added); *see also* Loeb v. Loeb, 72 N.C. App. 205, 324 S.E.2d 33, *cert. denied*, 313 N.C. 508, 329 S.E.2d 393 (1985) (use of the singular article in the statute was critical factor in court's determination that joint gift of property was not included within the separate property definition).

149. In Collins v. Davis, 68 N.C. App. 588, 315 S.E.2d 759, *aff'd*, 312 N.C. 324, 321 S.E.2d 892 (1984), plaintiff had invested $4,500 in his paramour's checking account, and the money was used to purchase a house titled in her name alone. She refused to give up the house when the parties separated and the plaintiff sued for unjust enrichment. The court of appeals reversed a directed verdict for defendant, holding that it was not the case that "couples living together . . . are incapable of entering into enforceable express or implied contracts." *Id.* at 592, 315 S.E.2d at 762. It added that if the payment had been founded on illicit sexual intercourse, the claim would be barred on public policy grounds; but otherwise, equity's "doors are not automatically closed to those that are immoral." *Id.*

150. N.C. GEN. STAT. § 50-20(b)(2) (Supp. 1985).

151. *See supra* text accompanying note 138. Specific items acquired by bequest, devise or descent will also normally be matters of record, and thus should be easier to trace.

sumptively marital.[152] As noted previously, the latter presumption can be overcome only by "clear, cogent and convincing" evidence to the contrary.[153] In most states wedding gifts are presumed to be marital, absent some showing of a contrary intention on the part of the donor.[154] On the other hand, proof that a spouse was the recipient of a "gift" that was actually earned during the marriage,[155] or of an inheritance that derived from a contractual arrangement with the testator,[156] should be sufficient for classification of such property as marital.

Interspousal gifts present considerably more complex issues. In virtually all states gifts between spouses are presumed to be marital property;[157] indeed, a presumption more consistent with the partnership theory of marriage can hardly be imagined. Several North Carolina cases have reached the same commonsense conclusion.[158] The statute itself, however, goes somewhat further: "property acquired by gift from the other spouse during the course of the marriage shall be considered separate property only if such an intention is stated in the conveyance."[159] Thus, the section appears to create a presumption that can only be overcome by a "statement" of a contrary intent "in the conveyance."

Speculation on the effect of this section has long centered on this unusual language: would, for example, an oral gift proved to have been accompanied by the necessary contrary intent be sufficient to classify a gift as separate property? The question remains unanswered, although in *Talent v. Talent*[160] the court held that the husband's admission at trial that he had intended gifts of jewelry to his wife to be her separate property was binding on him.[161] This holding arguably suggests that something less than a written conveyance would satisfy the statute, but the precise language would still appear to require some more formal indicia of intent than is necessary with ordinary gifts.

The more common, and more significant, problem this section poses con-

152. *See supra* notes 40-41 and accompanying text.

153. Loeb v. Loeb, 72 N.C. App. 205, 210, 324 S.E.2d 33, 38, *cert. denied*, 313 N.C. 508, 329 S.E.2d 393 (1985). *But see* Crumbley v. Crumbley, 70 N.C. App. 143, 318 S.E.2d 525 (1984) (court did not require such proof to rebut a gift presumption in a situation in which husband's mother had deeded land to the husband and wife). For cases in which the presumption was overcome, see Hull v. Hull, 591 S.W.2d 376 (Mo. Ct. App. 1979); *In re* Marriage of Herron, 186 Mont. 396, 608 P.2d 97 (1980).

154. *See, e.g.*, Darwish v. Darwish, 100 Mich. App. 758, 300 N.W.2d 399 (1980); Nehorayoff v. Nehorayoff, 108 Misc. 2d 311, 437 N.Y.S.2d 584 (1981). The North Carolina courts have not addressed this issue.

155. *See In re* Marriage of Cook, 117 Ill. App. 3d. 844, 453 N.E.2d 1357 (1983); L.GOLDEN, *supra* note 1, § 5.21.

156. *See, e.g.*, Downer v. Bramet, 152 Cal. App. 3d 837, 199 Cal. Rptr. 830 (1984).

157. *See* Sharp, *supra* note 6, at 263.

158. *See, e.g.*, Manes v. Harrison-Manes, 79 N.C. App. 170, 338 S.E.2d 815 (1986); Dewey v. Dewey, 77 N.C. App. 787, 336 S.E.2d 451 (1985); Loeb v. Loeb, 72 N.C. App. 205, 324 S.E.2d 33, *cert. denied*, 313 N.C. 508, 329 S.E.2d 393 (1985).

159. N.C. GEN. STAT. § 50-20(b)(2) (Supp. 1985). This language also implies that gifts exchanged between the spouses prior to marriage would retain their separate character.

160. 76 N.C. App. 545, 334 S.E.2d 256 (1985).

161. *Id.* at 554, 334 S.E.2d at 261. In Dewey v. Dewey, 77 N.C. App. 787, 336 S.E.2d 451 (1985), the lower court's finding that the wife's separate property contributions to the marital home had been gifts was "supported by [her] testimony that she freely and voluntarily contributed her funds to the marriage." *Id.* at 789, 336 S.E.2d at 452. In fact, the parties had lived in five different homes. *Id.* It is unlikely that the wife would, in any event, have been able to trace her contribution.

cerns the circumstances under which courts will deem gifts of separate property to have been made to the marital estate.[162] The most obvious indicia of such an intent undoubtedly occurs when one party contributes separate property to an entireties estate. Virtually all other states that have addressed this question have concluded that such conduct gives rise to a presumption of gift to the marital estate,[163] so that the separate property contribution may not be traced out unless the presumption is rebutted.[164]

Resolution of this issue in North Carolina was not quite so obvious, owing to a peculiar combination of circumstances and a misapprehension of conflict between the interspousal gift and exchange provisions of the statute.[165] In the significant case of *McLeod v. McLeod*,[166] however, the court of appeals rejected the wife's contention that the source of funds rule should be applied to deter-

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162. It is difficult to conceive of any situation in which the marital estate could, or would have any possible reason to, make a gift to *itself*, because the source of such gift would, by definition, already be marital property. Therefore, it would seem that any gift to the marital estate by a spouse would have to derive from that spouse's separate estate.

163. *See In re* Marriage of Moncrief, 36 Colo. App. 140, 535 P.2d 1137 (1975); Turpin v. Turpin, 403 A.2d 1144 (D.C. 1979); *In re* Marriage of Rogers, 86 Ill. App. 3d. 904, 422 N.E.2d 635 (1981); *In re* Marriage of Butler, 346 N.W.2d 45 (Iowa Ct. App. 1984); Carter v. Carter, 419 A.2d 1018 (Me. 1980).

164. Rebuttal of the presumption would result in application of the source of funds rule. *See In re* Marriage of Moncrief, 36 Colo. App. 140, 535 P.2d 1137 (1975); Turpin v. Turpin, 403 A.2d 1144 (D.C. 1979); *In re* Marriage of Rogers, 86 Ill. App. 3d. 904, 422 N.E.2d 635 (1981); *In re* Marriage of Butler, 346 N.W.2d 45 (Iowa Ct. App. 1984); Carter v. Carter, 419 A.2d 1018 (Me. 1980); *see also* McLeod v. McLeod, 74 N.C. App. 144, 158, 327 S.E.2d 910, 920 (property conveyed to other spouse in form of tenancy by entireties raises rebuttable presumption of gift), *cert. denied*, 314 N.C. 331, 333 S.E.2d 488 (1985).

165. N.C. GEN. STAT. § 50-20(b)(2) (Supp. 1985) (emphasis added) states that "[p]roperty acquired in exchange for separate property shall remain separate property regardless of whether the title is in the name of the husband or wife or both *and shall not be considered to be marital property unless a contrary intention is expressly stated in the conveyance.*" The italicized portion of this section was added by amendment in 1983. Act of June 29, 1983, ch. 640, § 2, 1983 N.C. Sess. Laws 599, 599 (codified at N.C. GEN. STAT. § 50-20(b)(2) (Supp. 1985)). Prior to the addition of the italicized language, it might have been literally impossible for any interspousal gifts to occur. *See* Sharp, *supra* note 6, at 265-67. In effect, a spouse would have been able to trace out any separate property that had been a gift to the marital estate.

In Mims v. Mims, 305 N.C. 41, 286 S.E.2d 779 (1982), the supreme court abrogated the traditional common-law presumption of gift that had operated only in favor of a wife to whom the husband had transferred separate property. In the course of its discussion, the supreme court observed in dicta that

> in the context of a divorce and the "equitable distribution" of all "marital property" the legislature had opted for a rule that where land or personalty is purchased with the "separate property" of either spouse, it remains the "separate property" of the spouse regardless of how the title is made.

Id. at 53, 286 S.E.2d at 787. Even so, the court cautioned, it did not intend "definitively to construe" the gift and exchange provisions of the new act, which was not applicable to the case before it. *Id.* That the supreme court has come to regard these rather precipitous conclusions in *Mims* as dicta is strongly indicated by White v. White, 312 N.C. 770, 773, 324 S.E.2d 829, 831 (1985), in which the Court noted that "[t]hough touched upon in *Mims v. Mims* . . . this is our first opportunity to expressly address the Act."

As the court of appeals noted in a subsequent case, moreover, the general assembly had amended this provision by the addition of the language "unless a contrary intention is expressly stated in the conveyance," Act of June 29, 1983, ch. 640, § 2, 1983 N.C. Sess. Laws 599, 599 (codified at N.C. GEN. STAT. § 50-20(b)(2) (Supp. 1985)), after, and in apparent response to, the rather Draconian suggestion of *Mims*. McLeod v. McLeod, 74 N.C. App. 144, 156, 324 S.E.2d 910, 918, *cert. denied*, 314 N.C. 331, 333 S.E.2d 488 (1985).

166. 74 N.C. App. 144, 327 S.E.2d 910, *cert. denied*, 314 N.C. 331, 333 S.E.2d 488 (1985).

mine her separate share of an entireties estate.[167] The court reasoned instead that "where a spouse furnishing consideration from separate property causes property to be conveyed to the other spouse in the form of tenancy by the entireties, a presumption of gift of separate property to the marital estate arises, which is rebuttable by clear, cogent, and convincing evidence."[168] Only if the presumption were overcome could a source of funds analysis be applied to determine the proportional ownership shares of the separate estates.[169]

The court also correctly observed that only a gift result was consistent with the general partnership principles of the Act,[170] and with the common-law rule that a presumption of gift arises with interspousal transfers to entireties estates.[171] More significantly, the *McLeod* court went to some lengths to illustrate that this interpretation is consistent with the exchange provision of North Carolina General Statute section 50-20(b)(2).[172]

Under the gift provision courts will presume separate property contributed to an entireties estate to be marital, unless an intention that it remain separate is "stated in the conveyance."[173] The same property simultaneously loses its separate character under the exchange provision, because the entireties transfer *is*, in

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167. *Id.* at 154, 327 S.E.2d at 916-17. The wife's separate property contribution of $8,000 and the husband's $2,000 contribution had been used to make a down payment on a home purchased for $23,000. At the time the parties separated the home had a value of approximately $126,000. The wife was thus seeking, in effect, to leverage her separate property contribution.

168. *Id.*

169. *Id.* at 158, 327 S.E.2d at 919. The court specifically declined to address the issue of what would constitute sufficient evidence of the "contrary intention" not to make a gift. *Id.* at 158 n.2, 327 S.E.2d at 919 n.2. Significantly, however, it did draw a distinction between evidence indicating the *purpose* behind a gift—to avoid tax consequences, for example—and evidence indicating that no gift had been intended. In other words, that a spouse made a gift to the entireties for the purpose of achieving some ancillary objective in no way alters the conclusion that a gift was made.

It should perhaps be noted that *McLeod* was not the first case to address the "intention to the contrary" language of the statute. In Crumbley v. Crumbley, 70 N.C. App. 143, 318 S.E.2d 525 (1984), the husband had deeded property—inherited from his father—to his mother, to clear up a mistake in another deed to property that had been left to his brother. *Id.* at 144, 318 S.E.2d at 526. The mother then deeded the property back to the husband and wife in the entireties. *Id.* The court held that the property remained the separate property of the husband, based on the exchange provision and the absence of any expression of an intent that the property be marital. *Id.* at 145, 318 S.E.2d at 526. It apparently overlooked the fact the entireties estate had been created by a third party transfer, and not by the husband. Arguably, the intention to the contrary language of the exchange provisions should not have been relevant. It is this factor that may have led the *McLeod* court to ignore the *Crumbley* decision altogether.

170. *McLeod*, 74 N.C. App. at 155, 327 S.E.2d at 917.

171. *Id.* The supreme court recently enunciated this common-law rule in Mims v. Mims, 305 N.C. 41, 286 S.E.2d 779 (1982). For a discussion of the *Mims* case, see *supra* note 165. As the supreme court noted, with some understatement, in *Mims*, the gift presumption is "more in accord with the probabilities of the marital state" and with the intentions of the parties. *Mims*, 305 N.C. at 54, 286 S.E.2d at 788.

172. *McLeod*, 74 N.C. App. at 155, 327 S.E.2d at 917. The conveyance of such property into an entireties estate is itself, reasoned the court, an indication of the " 'contrary intention' to preserving separate property required by the statute." *Id.* at 154, 327 S.E.2d at 916-17.

173. *Id.* at 155, 327 S.E.2d at 917. It might be noted that the interspousal gift provision creates a presumption of marital property unless an intention to the contrary is "stated in the conveyance," whereas the exchange provision requires that separate property retain its character unless a contrary intention is "expressly stated in the conveyance." N.C. GEN. STAT. § 50-20(b)(2) (Supp. 1985). Thus far, however, no case has attached any significance to this distinction.

fact, a statement of the necessary contrary intent.[174] In essence, the opinion reaches the common-sense result, and well-established rule, that a party's intention to make a gift—an intention that is surely thrown into sharpest relief when separate property is transferred into a joint estate—should control the disposition of such property. A contrary holding easily could have undermined the fundamental purposes of the statute.

The logic of the *McLeod* opinion, with its underlying focus on intent, is not limited to gifts to the entireties estate. Notwithstanding this logic, other cases have reached such a restrictive result.[175] For example, in *Manes v. Harrison-Manes*[176] the court of appeals expressly declined to extend the gift presumption to jointly held personal property—a joint bank account. The court relied both on *McLeod*[177] and its own conclusion that such an extension would defeat the purpose of the exchange provision.[178]

This restriction of the *McLeod* result is unfortunate. Such a rule frustrates the intentions of both donor and donee. The result is particularly unfortunate in situations in which separate funds are deposited into joint savings or bank accounts. In these situations the indicia of an intent to make a gift to the marital estate is almost indistinguishable from that with a contribution to an entireties estate. Opinions that have drawn such a distinction have rested, to a large degree, on a series of cases of highly questionable validity.[179] The traditional rule in North Carolina[180] was stated clearly in *Smith v. Smith*:[181] no presumption of gift arose from placing personal property in joint names.[182]

The logic and foundation for the *Smith* rule, however, were firmly embedded in principles that are inapplicable and inconsistent with equitable distribution concepts of property,[183] that created the very inequities which the new

174. *McLeod*, 74 N.C. App. at 155, 327 S.E.2d at 917.

175. *See, e.g.*, Brown v. Brown, 72 N.C. App. 332, 334, 324 S.E.2d 287, 288 (1985); Loeb v. Loeb, 72 N.C. App. 205, 213, 324 S.E.2d 33, 39, *cert. denied*, 313 N.C. 508, 329 S.E.2d 393 (1985). By way of attempting to distinguish its results from the transmutation through commingling approach, the *McLeod* court stated that "[h]ere, however, only a titling of property as tenants by the entirety supplies the specific intent necessary to transform separate property into marital." *McLeod*, 74 N.C. App. at 156, 327 S.E.2d at 918. As noted previously, the court's anxiety to distance itself from the transmutation theory appears unwarranted. *See supra* note 136.

176. 79 N.C. App. 170, 338 S.E.2d 815 (1986).

177. *Id.* at 172, 338 S.E.2d at 816.

178. *Id.*; *see also* Dewey v. Dewey, 77 N.C. App. 787, 336 S.E.2d 451 (1985) (absent statement of contrary intent, financial contributions by wife from separate property for down payments and improvements on family homes held in the entireties become marital property).

179. Dewey v. Dewey, 77 N.C. App. 787, 336 S.E.2d 451 (1985); Brown v. Brown, 72 N.C. App. 332, 324 S.E.2d 287 (1985); Loeb v. Loeb, 72 N.C. App. 205, 324 S.E.2d 33, *cert. denied*, 313 N.C. 508, 329 S.E.2d 393 (1985).

180. *See* Sharp, *supra* note 6, at 264.

181. 255 N.C. 152, 120 S.E.2d 575 (1961)

182. *Id.* at 154-55, 120 S.E.2d at 578. The supreme court held that "in the absence of evidence to the contrary the person making a deposit in a bank is deemed to be the owner of the fund." *Id.* at 154, 120 S.E.2d at 578.

183. At the time *Smith* was decided, of course, the concept of marital property did not exist. Thus, the only issue was whether a husband's deposit of "separate" funds (money earned from his farm) into a joint bank account with his wife could constitute a gift to her separate estate. Strictly speaking, *Smith* held only that there was no "gift" to the separate estate because the husband had

statute was specifically intended to remedy in the first instance,[184] and that the supreme court has clearly rejected in other contexts.[185] Thus, there appears to be no justification for the courts' continued reliance on this discredited rationale to lend support to the proposition that deposits into joint accounts should be denied the benefit of the gift presumption applicable with entireties contributions.[186]

In summary, it appears that holdings which distinguish between jointly-held personal property and entireties property for purposes of application of the interspousal gift presumption rest on rather frail foundations. Perpetuation of this distinction would seem not only to undermine the partnership principles of the statute, but also to ignore what was the implicit foundation of *McLeod* in the first instance: that a gift made with the necessary expression of contrary intent is *not* an "exchange" of separate property at all.[187] The integrity of the exchange provisions would not be threatened by a rule that would allow separate property to undergo a theoretically endless number of exchanges and still retain its separate character, so long as it was not *given away*.[188] Moreover, it appears particularly ironic as well as profoundly inconsistent with the purposes and policies of the statute, to forbid gifts to the personal estate of the marital unit, when a spouse clearly can make gifts of separate property to the personal estate of any *other* third party.

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failed to divest himself completely of control over the money. *See id.* at 155-57, 120 S.E.2d at 578-79. Such logic is clearly inapplicable with a gift to a *marital* estate.

184. In particular, the following language from *Smith* should be noted:

> The income and profits from a farm owned by the husband are his sole and separate property. The husband has the duty to provide necessaries for his wife and must support and maintain her. . . . *North Carolina has no community property law.* The domestic services of a wife . . . are presumed to be gratuitous, and the performances of work and labor beyond the scope of her usual household and marital duties . . . is also presumed to be gratuitous.

Id. at 155-56, 120 S.E.2d at 579 (emphasis added). This logic is, of course, identical with that used to reach the result in Leatherman v. Leatherman, 297 N.C. 618, 256 S.E.2d 793 (1979). *See supra* note 4.

185. *See, e.g.*, Mims v. Mims, 305 N.C. 41, 286 S.E.2d 779 (1982) (abrogating the traditional common-law presumption of gift that had operated only in favor of a wife to whom the husband had transferred separate property). For a discussion of *Mims*, see *supra* note 165.

186. Reliance on the *Smith* case seems to have begun in Loeb v. Loeb, 72 N.C. App. 205, 213, 324 S.E.2d 33, 39, *cert. denied*, 313 N.C. 508, 329 S.E.2d 393 (1985); *see also* Manes v. Harrison-Manes, 79 N.C. App. 170, 338 S.E.2d 815 (1986) (use of separate property to acquire entireties property raises rebuttable presumption of gift to marital estate but presumption applicable only to real property); Brown v. Brown, 72 N.C. App. 332, 324 S.E.2d 287 (1985) (separate property deposited in joint savings account remains separate property).

187. "Exchange" clearly implies that something of value has been received in return. "Gift," on the other hand, implies the opposite conclusion. Interpretation of the word "exchange" to include gifts is a result that the statute does not require and that logic clearly does not recommend.

188. Ironically, the court of appeals seemed to recognize this fact in Brown v. Brown, 72 N.C. App. 332, 324 S.E.2d 287 (1985), even as it enunciated the contrary position. The court held that separate property could be traced out of a joint bank account because the balance of the account had never fallen below the amount of the separate funds contributed to it. *Id.* at 336, 324 S.E.2d at 289. The opinion thus clearly appears to recognize that a gift could have been made had the separate property no longer been in the account to be retreived—basically a *fait accompli* gift result. *See also supra* note 140 (discussing the approach taken by the *Brown* court).

C. *Increases in Value and Income*

Many of the issues associated with increases in value of, and income from, separate property are similar to those that have already been treated in the discussion of marital property. As noted previously, the North Carolina increase in value provision is rather all-encompassing: "The increase in value of separate property . . . shall be considered separate property."[189] A literal interpretation of such language would, of course, create a result indistinguishable from that in *Leatherman v. Leatherman*[190] and would undermine, almost in a single stroke, the very purpose of the statute.[191]

Fortunately, the court of appeals reached this conclusion at an early point in its interpretation of the statute,[192] and in *Wade v. Wade*[193] it interpreted this provision as "referring only to passive appreciation of separate property, such as that due to inflation, and not to active appreciation resulting from the contributions, monetary or otherwise, by one or both of the spouses."[194] The distinction between active and passive increases in values is simply an application of source of funds principles to separate property appreciation.[195] This distinction projects onto increases in value of such property the same partnership principles and the same policy of securing returns on investment that have been used to govern the interpretation of the word "acquired."

Wade, however, did blur the distinction between application of the source of funds analysis to increases in value of separate property, where the active/passive dichotomy furnishes the only common-sense means of determining an appropriate return investment for each estate, and application of that analysis to actual acquisition of property by both estates.[196] And although some of the confusion engendered by *Wade* does persist, subsequent cases appear to have begun to restrict the operation of the active/passive distinction to increases in

189. N.C. GEN. STAT. § 50-20(b)(2) (Supp. 1985). Such an exclusion of increases in value of *all* types of separate property appears to be unique. *See* L. GOLDEN, *supra* note 1, § 102, at 138; Sharp, *supra* note 6, at 260.

190. 297 N.C. 618, 256 S.E.2d 793 (1979).

191. The precise analogy to *Leatherman*, discussed *supra* note 4, was drawn by the court of appeals in Wade v. Wade, 72 N.C. App. 372, 379, 325 S.E.2d 260, 267-68 (1985). In Phillips v. Phillips, 73 N.C. App. 68, 326 S.E.2d 57 (1985), the court developed the analogy still further and concluded that "[i]f this is the case, then equitable distribution simply is no help to the person whose spouse is a businessman or entrepreneur, who brings considerable corporate property into the marriage, and acquires most of the assets used in the marriage by profit-making manipulation of corporate funds." *Id.* at 72, 326 S.E.2d at 60.

192. The earliest case that arguably addressed the issue was Turner v. Turner, 64 N.C. App. 342, 307 S.E.2d 407 (1983), in which the court implied that a literal interpretation of this section might be applied. As noted previously, however, this aspect of *Turner* has been effectively, if not actually, overruled by subsequent cases. *See supra* note 93 and accompanying text.

193. 72 N.C. App. 372, 325 S.E.2d 260 (1985).

194. *Id.* at 379, 325 S.E.2d at 268.

195. *See* Sharp, *supra* note 6, at 260-62; *supra* notes 94-98 and accompanying text (discussing *Wade*).

196. *See supra* note 112 and accompanying text. This distinction eliminates any active/passive determination with property that is acquired during marriage, so that increases in value are shared, in proportion to their acquisition by each estate, and without regard to any active/passive distinction.

value of separate property. Two cases involving closely held corporations are especially important in this context.

In *Phillips v. Phillips*[197] plaintiff husband had owned ninety-eight percent of a small corporation before marriage.[198] During the parties' twelve year marriage, the corporation had increased in value, and loans from it had been used to acquire, among other assets, subdivision lots, a Swiss annuity with a value of 92,000 dollars—titled in the husband's name—other business property, and a small air charter corporation.[199] Plaintiff claimed that all these assets, plus the increase in value of the corporation itself, should be exempted from inclusion as marital property on the grounds that they merely were increases in value of separate property.[200]

The court of appeals disagreed. The court realized that the very nature of a closely held corporation rendered the husband's contention totally inconsistent with the purposes and policies of the statute.[201] Furthermore, the corporate loans used to purchase the assets at issue had clearly been paid off, at least in part, by marital efforts. The court then approved the active/passive distinction set forth in *Wade* and instructed the lower court to carry out three tasks.[202] These instructions deserve careful attention. First, the lower court should "attempt to determine the 'active appreciation' of the . . . corporation during the marriage . . . that is, the increase in net value due to the contributions in personal effort or money earned during the marriage by either or both of the spouses."[203] Second, the lower court should "determine the extent to which that increase in net value was siphoned off and used to purchase the assets at issue . . . ."[204] Last, the lower court should determine "the degree to which those assets increased in value due to plaintiff's or defendant's personal managerial efforts or investment of earnings."[205] The problem, of course, lies with the meaning of the third instruction. It could certainly appear to be a directive to apply an active/passive distinction to assets that had been actually "acquired" by the marital estate, thus perpetuating the confusion evidenced in *Wade* and depriving the marital estate of passive increases in value of property it had acquired.[206] In a later, more significant opinion, however, the court of appeals

197. 73 N.C. App. 68, 326 S.E.2d 57 (1985).

198. *Id.* at 72, 326 S.E.2d at 60.

199. *Id.* at 71-73, 326 S.E.2d at 59-60.

200. *Id.*

201. The court observed:

> Because he controlled a closely-held corporation, plaintiff could shift funds and reap profits without having to draw funds as more highly taxable direct income. We do not believe that merely by covering his transactions with the corporate veil plaintiff can claim that any assets acquired thereby are wholly insulated from equitable distribution.

Id. at 74, 326 S.E.2d at 61.

202. *Id.*

203. *Id.*

204. *Id.*

205. *Id.*

206. *See supra* note 113 and accompanying text. It is also possible that this language in *Phillips* could be interpreted to point to what would amount to a double-layered source of funds analysis, so that any increase in the value of the separate property portion of a dual property asset (such as the lot and aircraft in that case) would itself become subject to an active/passive distinction. This same

interpreted *Phillips* to have reached an "acquisition" result: "assets acquired [from active increases in value of] the corporation could be *marital* property, if such assets were a product of the active appreciation of the corporation and/or actually appreciated during the marriage."[207]

In any event, *Phillips* does stand squarely for the proposition that an active/passive source of funds analysis should be applied to determine the classification of increases in value of closely held corporations. And despite some evidence of a lingering confusion in its instructions, the case apparently also holds that assets acquired with such active increases in value should themselves be marital.[208] On the whole, moreover, the opinion is indicative of the court's growing familiarity and sophistication with the intricacies of a source of funds analysis.

The high-water mark in this process, however, is undoubtedly the opinion in *McLeod v. McLeod*.[209] In *McLeod* plaintiff husband, through inheritance and separate property exchanges, originally owned some thirty percent of the corporation whose classification was in dispute. During the course of the twenty-one year marriage, the corporation redeemed the remaining outstanding shares of stock, so that plaintiff was the sole owner of the corporation at the date of separation. Plaintiff contended, apparently with success at the lower court level, that only his salary should be considered as marital property, a proposition that the court of appeals quickly rejected as unreasonable.[210] The "corporate veil," the court held, could not be used to obscure the real source of the increase in value of this asset.[211]

The court concluded, therefore, that although plaintiff's initial interest was separate property, any further increase in value due to "active" factors should be

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possibility is also strongly suggested by the court in McLeod v. McLeod, 74 N.C. App. 144, 327 S.E.2d 910, *cert. denied*, 314 N.C. 331, 333 S.E.2d 488 (1985), in which the court explained in dicta that the source of funds approach

> would dictate that each party retain as separate property the amount he or she contributed to the down payment, plus the increase on that investment due to passive appreciation; increases on that investment of separate property due to active appreciation, and amounts contributed by the marital unit plus increases on those amounts, would be marital property subject to equitable distribution.

Id. at 154, 327 S.E.2d at 916. Application of the source of funds approach, first to determine marital and separate property acquisitional shares in dual property, then to determine what portion of the separate property increase in value was caused by active factors, would undoubtedly involve lower courts in complex tracing and valuation procedures. *See supra* notes 120 & 129-30. It would also, however, avoid an undue leveraging of the separate estate, a major weakness in various types of source of funds analyses. *See e.g.*, Graham, *supra* note 86, at 53-54. It should be noted that the *McLeod* court was discussing the source of funds analysis that should be applied were the presumption of gift with entireties property to be overcome.

207. McLeod v. McLeod, 74 N.C. App. 144, 149, 327 S.E.2d 910, 914 (emphasis added), *cert. denied*, 314 N.C. 331, 333 S.E.2d 488 (1985).

208. This is, of course, the correct result. Assets acquired by marital funds—active increase in value of separate property—should be marital. As noted above, *McLeod* has interpreted *Phillips* in this fashion. *See supra* note 206.

209. 74 N.C. App. 144, 327 S.E.2d 910, *cert. denied*, 314 N.C. 331, 333 S.E.2d 488 (1985).

210. *Id.* at 151, 327 S.E.2d at 915. The court relied, as had the *Phillips* court, on the "broad discretion" that could be exercised "in allocating salary, dividends, and retained earnings." *Id.*

211. *Id.* at 149, 327 S.E.2d at 914 (*quoting* Phillips v. Phillips, 73 N.C. App. 68, 74, 326 S.E.2d 57, 61 (1985)).

considered marital property.[212] It went to some lengths to point out, moreover, that the "redemption by the corporation of all outstanding shares, whereby plaintiff became the sole owner," should be deemed an active appreciation of his original shares.[213] The court thus strongly implied that most, if not all, of the increase in value of plaintiff's separate property interest would be marital.[214]

McLeod is significant for several reasons. First, it is a clear and straightforward example of the application of the source of funds analysis to the appreciation of separate property. Even more important, however, it strongly reinforces the principle that "active" increases in value should be construed broadly. It implicitly recognizes that any marital "funds, talent, or labor"[215] that are expended for the benefit of separate property will automatically result in a depletion of the marital estate; therefore, they must be credited to the marital estate under the most fundamental of partnership principles.

This kind of functional analysis of the word "active" is of great significance. Such an analysis opens the door to a flexible approach, under which increases in value should be classified according to whether the marital efforts that "otherwise would have augmented the marital estate"[216] were expended for separate property purposes. In other words, a denial of benefits to the marital estate may sometimes be equated with its depletion. As the *McLeod* court realized, the "mere" preservation of separate property may sometimes result in a depletion of the marital estate.[217] For example, if separately owned investments are retained intact, and presumably increase in value due simply to such retention, the mari-

212. *Id.* at 150-51, 327 S.E.2d at 914-15. Its precise instructions were as follows: On remand, the trial court should make findings as to:

> (1) the value of plaintiff's minority interest at the time of inheritance . . . ; (2) the value of plaintiff's controlling interest at the date of separation . . . ; (3) the difference between the two; and (4) the proportion of that difference that is due to active appreciation . . . . The resulting amount is marital property subject to equitable distribution.

Id.

213. *Id.* at 151, 327 S.E.2d at 915.

214. It is also significant that the court seemed to suggest, following the lead of Roffman v. Roffman, 124 Misc. 2d 636, 476 N.Y.S.2d 713 (1983), that it might be appropriate to ignore altogether any "separate property" components of the "growth of a business that was the primary economic foundation of a lengthy marriage." *McLeod*, 74 N.C. App. at 150, 327 S.E.2d at 914.

215. *McLeod*, 74 N.C. App. at 151, 327 S.E.2d at 915. The *Wade* court had reached a similar conclusion. *Wade*, 72 N.C. App. at 379, 325 S.E.2d at 268 (active appreciation to include the contributions, "monetary or otherwise" of the spouses); *see also* Lawrence v. Lawrence, 75 N.C. App. 592, 595, 331 S.E.2d 186, 188 (1985) (active participation includes monetary and other contributions of the spouse); Phillips v. Phillips, 73 N.C App. 68, 74, 326 S.E.2d 57, 61 (1985) (monetary and other contributions by the spouse can result in active participation). In *Wade* the court thus implicitly rejected any notion that the direct/indirect contribution distinction drawn in subsection (c)(8) of the statute, dealing with distributional factors, should be of any relevance in the definition stage. In Cable v. Cable, 76 N.C. App. 134, 137, 331 S.E.2d 765, 767 (1985), the court of appeals reached this result explicitly.

216. *McLeod*, 74 N.C. App. at 148, 327 S.E.2d at 913.

217. *Id.* at 149, 327 S.E.2d at 913. The court cautioned that:

> We do not intend by this analysis to draw a bright line whereby appreciation in passive investments such as bank accounts or securities, not actively increased by the skill and labor of the spouse who inherited or brought them to the marriage, but which the parties were able to preserve intact only because they spent marital funds, invariably remains separate property.

Id. at 149 n.1, 327 S.E.2d at 914 n.1.

tal estate could be deemed to have contributed actively to what would appear to be a technically "passive" increase in value of separate property, because the marital estate was depleted by everyday living expenses.[218]

Thus, the active/passive distinction itself arguably should be viewed as a shorthand, and somewhat oversimplified, means of determining whether the marital estate played a *functional* role in the increase in value of, or in some instances the preservation of, separate property.[219] Certainly, there is no "bright line" distinction between active and passive increases in value,[220] and any attempt to create one is likely to do more harm than good. Whatever distinctions are ultimately drawn should be based on a substantive analysis, not only of the technical source of such increase, but on its effect on the marital estate as well.

Although the North Carolina courts have not yet addressed the issue, it seems that the same active/passive considerations that courts use to determine the classification of increases in value of separate property should also be employed to determine the classification of income from separate property. An initial, and obvious, basis for this conclusion is that the statute itself treats both types of assets identically, thus leaving no issue of any possible legislative intent that they be subjected to different treatment.[221] Analytically there is no principled means, or reason, to draw a distinction between increases in value of, or income from, separate property. Each derives from sources that may be either independent of, or directly the product of, marital efforts; and each thus requires a source of funds approach to implement the return of investment principle. A failure to discriminate between active and passive income-producing sources would, no less than with treatment of increases in value, create a potential for inequitable results that could easily undermine the fundamental purposes of the statute.

It is important—if not now obvious—to note that the distinction between income from and increase in value of property is often exceedingly difficult, if not impossible, to draw. Cases from other states make clear that, for example, the decision whether to classify stock splits or dividends as "income" or an "increase in value" turn almost wholly on which of those labels would result in marital property inclusion.[222] Because an increase in value label is more likely

218. In some states the active/passive distinction has been identified with increase or decrease in value over which the spouses had no control. *See, e.g.*, W. VA. CODE § 48-2-32(d)(2) (1986). Even under this test, however, the same result can be reached, because a *decision* to preserve separate property at the expense of marital funds clearly indicates a considerable element of control.

219. *But see* Cable v. Cable, 76 N.C. App. 134, 137, 331 S.E.2d 765, 767 (1985) (court apparently considered such marital efforts to preserve separate property as a distributive factor).

220. *See McLeod*, 74 N.C. App. at 149, 327 S.E.2d at 913-14. The supreme court has clearly opted for an analytical rather than a mechanistic approach for resolving similar issues in another context. *See supra* note 64.

221. "The increase in value of separate property and the income derived from separate property shall be considered separate property." N.C. GEN. STAT. § 50-20(b)(2) (Supp. 1985).

222. *See, e.g.*, Nelson v. Nelson, 114 Ariz. 369, 560 P.2d 1276 (1977); Halsey B.S. v. Charlotte S.S., 419 A.2d 962 (Del. 1980); *In re* Marriage of Smith, 86 Ill. 2d 518, 427 N.E.2d 1239 (1981); Arneson v. Arneson, 120 Wis. 2d 236, 355 N.W.2d 16 (1984); *see also* Sousley v. Sousley, 614 S.W.2d 942 (Ky. 1981) (court classified the inflationary increase in value of the husband's separate property—which would have been separate property—as "income," which was marital property).

to result in classification of the stock split or dividend as separate in most states,[223] the asset is in turn more likely to be characterized as "income," precisely in order to include it as divisible property.[224] Such result-oriented cases reduce what should be a substantive and functional inquiry to the level of technical and arbitrary affixing of labels. Moreover, it is clear that such practical difficulties and less than principled results can be eliminated by the simple means of applying the same analysis to both increases in value of, and income from, separate property.[225] North Carolina courts have already laid the foundation for adoption of such an approach.

V. VALUATION AND RELATED ISSUES

A. *General Principles*

Although valuation may often present the most complex practical problems for lawyers and judges, there have been considerably fewer major analytical problems with this stage of equitable distribution. This is true, in the first instance, because the area is one that is largely reserved to the exercise of judicial discretion.[226] It is also the case, however, that valuation, unlike other stages of equitable distribution, presents many issues with which courts have considerable familiarity. Thus, in contrast to other stages of the distribution process, there are some well-developed precedents on which courts may draw in resolving some of the problems that arise in this context.

Although appellate courts have not addressed some of the complex problems associated with valuation of marital assets,[227] these courts have settled many of the broad principles that will govern implementation of this part of the statute. Valuation is, of course, the second of three mandatory judicial tasks with equitable distribution—it follows the identification, and precedes the distribution, of marital property.[228] It is important to emphasize, moreover, that

223. Apparently only North Carolina and Virginia classify income from separate property as separate. *See* L. GOLDEN, *supra* note 1, § 5.17, at 112. Professor Golden notes in part that "[t]his minority position is not reflective of the policies of equitable distribution insofar as the income resulted from the efforts of one or both of the spouses." *Id.* The point, in any case, is that other jurisdictions are likely to strain to label assets as "income" in order to include them as marital property.

224. An excellent example of this tendency is found in *In re* Marriage of Williams, 639 S.W.2d 236 (Mo. Ct. App. 1982), in which the court went so far as to classify calves born to a separately owned herd of cattle as "income" in order to avoid the separate property consequence that would have resulted from an "increase in value" label. *Id.* at 237.

225. It is quite possible, moreover, that North Carolina courts have already implicitly reached this result. Some of the assets and "increases in value" in *Wade*, *Phillips*, and *McLeod* might just as easily have been labeled as "income." But it is doubtful if the results in any of those cases would have changed had the issue been argued as "income" from separate property.

226. *See infra* text accompanying notes 264-68.

227. This is particularly true in the determination of the scope of discovery. *See infra* notes 285-90 and accompanying text. Many of the more technical aspects of valuation are beyond the scope of this Article, however.

228. *See, e.g.*, Nix v. Nix, 80 N.C. App. 110, 113, 341 S.E.2d 116, 118-19 (1986); Cable v. Cable, 76 N.C. App. 134, 137, 331 S.E.2d 765, 767 (1985); Wade v. Wade, 72 N.C. App. 372, 376-82, 325 S.E.2d 260, 266-70 (1985); Alexander v. Alexander, 68 N.C. App. 548, 550-51, 315 S.E.2d 772, 775 (1984).

these tasks are entirely distinct from one another. Issues of valuation should not be confused with, or influenced by issues of classification or distribution.[229]

The original version of the statute did not address the critical problem of ascertaining the date at which courts are to determine the values of marital property.[230] Section 50-21(b) of the North Carolina General Statute, an early amendment to the Act, remedied this problem. It requires that, for divorces obtained on the grounds of one year's separation,[231] courts must determine the value of marital property as of the date of separation of the parties.[232] Courts will also use the same date to determine the point after which marital property accumulations will cease.[233] As discussed previously, valuing assets at a date that will, at a minimum,[234] precede the date of trial by at least one year could create some difficulties, particularly with assets whose value may undergo marked fluctuations during that period.[235] More significantly, identification of the date of separation as the date at which assets will be valued may also create disputed issues of fact as to when separation actually did occur, given the peculiar reconciliation principles that have developed in North Carolina.[236]

On the other hand, there are some circumstances under which the lapse of time between the date of separation and the date of trial recommends use of the former for valuation purposes. Particularly when combined with the source of funds principles that have been adopted to govern the classification of marital assets acquired, or disposed of, after separation,[237] the current valuation date

229. Cable v. Cable, 76 N.C. App. 134, 137, 331 S.E.2d 765, 767 (1985), reached this result explicitly with regard to classification and distributional factors. The same result, however, is implicit with regard to all three stages of the process.

230. *See* Sharp, *supra* note 6, at 251-52.

231. This is, in most instances, the only grounds for divorce in North Carolina. *See supra* note 2. Under North Carolina General Statute section § 50-5.1, divorces may also be obtained, in very restricted circumstances, when parties have been separated for three years because of the insanity of one spouse. N.C. GEN. STAT. § 50-5.1 (1984).

232. N.C. GEN. STAT. § 50-21(b) (1984). The amendment was effective as to all cases pending August 1, 1983. Act of July 1, 1983, ch. 671, § 2, 1983 N.C. Sess. Laws 640, 640; *see also* Talent v. Talent, 76 N.C. App. 545, 552, 334 S.E.2d 256, 261 (1985) (date of separation is valuation date of marital property when grounds for divorce is one year's separation); Mauser v. Mauser, 75 N.C. App. 115, 120, 330 S.E.2d 63, 66 (1985) ("[W]hen divorce is granted on the grounds of one year's separation, marital property is to be valued as of the date of separation."); Weaver v. Weaver, 72 N.C. App. 409, 415, 324 S.E.2d 915, 919 (1985) ("[i]f divorce is granted on the ground of one year separation . . . the marital property shall be valued at the time of separation").

233. *See* N.C. GEN. STAT. § 50-20(b)(1) (Supp. 1985); *supra* text accompanying notes 48-52.

234. Under the terms of North Carolina General Statute section 50-21 equitable distribution may not precede a decree of absolute divorce. N.C. GEN. STAT. § 50-21(a) (1984); *see also* McIver v. McIver, 77 N.C. App. 232, 233, 334 S.E.2d 454, 455 (1985) ("[E]quitable distribution *may not precede* an absolute divorce."); McKenzie v. McKenzie, 75 N.C. App. 188, 189, 330 S.E.2d 270, 271 (1985) ("The equitable distribution *may not precede* a decree of absolute divorce."); Lofton v. Lofton, 71 N.C. App. 635, 636, 322 S.E.2d 654, 655 (1984) ("[T]he equitable distribution may not precede a decree of absolute divorce."). In fact, because most equitable distribution actions are reserved for trial following the granting of an absolute divorce, the period between separation and trial is likely to be well in excess of one year.

235. *See supra* note 51.

236. *See supra* text accompanying note 52. North Carolina's peculiar rules in this area also create the possibility that parties might seek, or resist, reconciliation in order to change, or preserve, the status quo valuation date. Again it should be emphasized that any rule that discourages attempts at reconciliation has little to recommend it.

237. *See supra* text accompanying notes 53-57.

operates as an effective deterrent to, or corrective for, spousal efforts to waste, convert, or otherwise diminish the value of marital assets after the parties separate. This is particularly well illustrated by *Mauser v. Mauser*,[238] in which the husband's transfer, immediately after separation, of 24,000 shares of closely held stock to his mother—for approximately one-fifth of their fair market value—was ultimately irrelevant for either valuation or definitional purposes. The stock, including its value at the date of separation, was reincluded in the marital estate.[239]

Moreover, to date there have been relatively few problems associated with use of the date of separation for valuation purposes. And, in many instances, even changes in the value of certain assets can be accommodated under the statute. When assets are distributed in kind, for example, inflationary increases in the value of property assigned to one spouse may often be offset by correlative increases in the value of property assigned to the other.[240] Similiarly, if an asset, particularly a marital home, must be sold to effect an equitable distribution of property, increases or decreases in its value can be accounted for by orders requiring a proportional division of the proceeds from such sale. With third party buyers, therefore, the result is that the parties will share, proportionately or equally, in the current market value of the asset. This was the outcome in *Dewey v. Dewey*,[241] in which the lower court apparently had valued the marital home at a time after the date of separation.[242] The court of appeals correctly reasoned, however, that the error was harmless, because the lower court had ordered an equal division of the proceeds of the sale, and thus any increase in value since the date of separation would not affect either party's distributive share.[243]

The result in *Dewey* does not transgress the statutory directive that property be valued as of the date of separation. That statutory mandate is satisfied when values, determined at the time of separation, have been used to determine the ultimate distributive *shares* of each party.[244] When an asset must be sold to effect the distribution ordered by a court, however, the sale price itself will, quite obviously, reflect the current market value of the asset. That the *value* of those previously determined proportional shares will ultimately also reflect any in-

238. 75 N.C. App. 115, 330 S.E.2d 63 (1985).

239. *Id.* at 120, 330 S.E.2d at 66.

240. It is not unreasonable to suggest, moreover, that a drastic increase—or decrease—in the value of, for example, a business, which would almost certainly be assigned to the spouse who had operated such business, could be a distributional factor under N.C. GEN. STAT. § 50-20(c)(12) (Supp. 1985) ("[a]ny other factor which the court finds to be just and proper"). Furthermore, courts may consider acts of either spouse "to maintain, preserve, develop, or expand; or to waste, neglect, devalue or convert such marital property, during the period after separation . . . and before the time of distribution." *Id.*

241. 77 N.C. App. 787, 336 S.E.2d 451 (1985).

242. *Id.* at 791, 336 S.E.2d at 453.

243. *Id.* at 791, 336 S.E.2d at 453-54. The same logic would, moreover, be applicable to any order for proportionate shares, whether equal or not, from sale proceeds.

244. North Carolina General Statute section 50-20(c) states that "[t]here shall be an equal division by using net value of marital property unless . . . ." N.C. GEN. STAT. § 50-20(c) (1984). The statute specifies also that values shall be determined on the date of separation. *Id.* § 50-21(b). The function of the value determination, however, is clearly to aid the court in a determination of whether an equal distribution would be equitable under § 50-20(c).

crease or decrease in value of the asset from the date of separation to the date of sale in no way defeats either the letter or the spirit of the requirement that the date of separation value be used to determine the distributive shares in the first instance.[245]

To duplicate this equitable and sensible result when one spouse wishes to purchase the other's marital share in the marital home, however, it is essential that the buyer spouse be treated as any other third party buyer. Thus, as the court of appeals recognized in *Appelbe v. Appelbe*,[246] a new appraisal of the home, reflecting its current market value, must be required in order for both spouses to receive their proportionate distributional shares.[247] In other words, anything other than a distribution in kind always will involve distributional shares whose value reflects, but is not based on, current market values.

The statute also requires that the "net value" of marital assets be determined.[248] As one of the earliest cases interpreting the Act explained, this term is to be accorded its "ordinary and commonly understood interpretation: i.e., market value, if any, less the amount of any encumbrance serving to offset or reduce market value."[249] Reliance on fair market, rather than net, value will therefore result in reversible error.[250] It is also clear that the statute requires that all marital assets be identified and valued.[251]

Beyond these relatively simple general principles, the major problems that have arisen with valuation have tended to involve issues of proof and standards of review. Parties may, of course, stipulate the value of assets, but when there is disagreement, the method or methods by which a court determines the value of property is largely a matter of judicial discretion. Findings of value are clearly issues of fact, not of law, so that such findings will be binding on appeal if supported by competent evidence.[252] With one exception, therefore, there have

245. In other words, distributive shares, determined on the basis of date of separation, cannot be equated with the ultimate value of those shares. Otherwise, it would appear that courts would have to reach the inconceivable result of requiring parties to sell an asset at a separation date value.

246. 76 N.C. App. 391, 333 S.E.2d 312 (1985).

247. *Id.* at 394, 333 S.E.2d at 313. The lower court had denied defendant-husband's motion that he be allowed to buy out his wife's share in the marital home, thus requiring that the home be listed with a real estate agency. The court of appeals reversed, noting that the trial court result would cause only additional costs to the marital estate and great inconvenience to defendant. It then reasoned that "since more than a year has passed since the property was last appraised, upon remand the court will have to determine its fair market value anew. If, after doing so, defendant is still willing and able to buy plaintiff's interest . . . the court should permit him to do so." *Id.*

248. N.C. GEN. STAT. § 50-20(c) (Supp. 1985).

249. Alexander v. Alexander, 68 N.C. App. 548, 550-51, 315 S.E.2d 772, 775 (1984); *see also* Poore v. Poore, 75 N.C. App. 414, 417, 331 S.E.2d 266, 269 (1985) (net value of property is its "market value, if any, less the amount of any encumbrances serving to offset the market value").

250. *See, e.g.*, Wade v. Wade, 72 N.C. App. 372, 376, 325 S.E.2d 260, 266 (1985); Brown v. Brown, 72 N.C. App. 332, 336, 324 S.E.2d 287, 290, (1985). The error is harmless when fair market and net value are the same. *See* Talent v. Talent, 76 N.C. App. 545, 556, 334 S.E.2d 256, 263 (1985); Little v. Little, 74 N.C. App. 12, 18, 327 S.E.2d 283, 288-89 (1985).

251. Little v. Little, 74 N.C. App. 12, 17, 327 S.E.2d 283, 288 (1985). Items having no net value are, reasonably enough, exempted from this requirement. *See* McManus v. McManus, 76 N.C. App. 588, 592, 334 S.E.2d 270, 273 (1985) (harmless error to have awarded deck furniture to wife, because lower court had found it had no net value).

252. Poore v. Poore, 75 N.C. App. 414, 422, 331 S.E.2d 266, 272 (1985). In Nix v. Nix, 80 N.C. App. 110, 341 S.E.2d 116 (1986), the court of appeals observed that "[w]hen there is conflicting

been relatively few appellate decisions dealing with the valuation of specific assets. That exception involves closely held corporations, professional practices, and the all important issue of goodwill—all areas for which the existence of clear judicial guidelines for the exercise of discretion is essential.

B. *Corporate and Professional Assets*

Valuation of professional and business assets is never an easy task. Valuing complex and intangible assets, such as the goodwill component of a professional practice, however, taxes the resources of lawyers and judges alike.[253] In North Carolina, as in many other states,[254] goodwill has been determined to be a distributable asset, which therefore must be valued for equitable distribution purposes.[255] Although *Weaver v. Weaver*[256] was the first case to address the issue, the leading North Carolina case on goodwill is unquestionably *Poore v. Poore*.[257]

The court of appeals in *Poore* vacated the decision of the lower court because it had failed, among other things, to include the value of any goodwill component in its valuation of the husband's dental practice.[258] The court wisely continued, however, to address valuation procedures in general, and goodwill issues in particular, in considerable detail. In so doing, it laid down important guidelines for dealing with such issues in the future and created potentially significant limits on the exercise of judicial discretion.

Although the *Poore* court recognized that individual circumstances would always vary, it took pains to note that valuation of a professional practice should nevertheless include the following factors: "(a) its fixed assets including cash, furniture, equipment and other supplies; (b) its other assets including accounts receivable and the value of work in progress; (c) its goodwill, if any; and (d) its liabilities."[259] The court went on to discuss several valuation methods or approaches that would, it implied, withstand appellate scrutiny.[260]

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testimony as to value, the trial court may not merely guess at a figure somewhere in between, but may arrive at such a middle figure after considering the factors involved in the various appraisals." *Id.* at 115, 341 S.E.2d at 119.

253. Under section 50-20(b)(2), "[a]ll professional licenses and business licenses which would terminate on transfer shall be considered separate property." N.C. GEN. STAT. § 50-20(b)(2) (Supp. 1985). Thus, North Carolina courts have been spared the issue confronted by many other courts of whether a professional degree should itself be considered marital property.

254. *See* L. GOLDEN, *supra* note 1, § 7.10.

255. *See infra* notes 256-64.

256. 72 N.C. App. 409, 324 S.E.2d 915 (1985). *Weaver* basically approved the use of a partnership agreement, which included a goodwill component, for determining the value of the husband's interest in an accounting partnership. In effect, it classified goodwill as marital property only in passing. *Id.* at 414, 324 S.E.2d at 918-19.

257. 75 N.C. App. 414, 331 S.E.2d 266 (1985).

258. *Id.* at 422, 331 S.E.2d at 272. The husband's expert had testified that the net value of the practice was $7,549. The wife's expert put the value at $232,000. *Id.* at 418, 331 S.E.2d at 269-70. The trial court, apparently considering only evidence on tangible assets and net income, arrived at a value of $73,561. *Id.* at 417, 331 S.E.2d at 269. The court of appeals held that this finding "[did] not appear to be based on a sound method of valuation nor is it supported by the evidence." *Id.* at 422, 331 S.E.2d at 272; *see also* Dorton v. Dorton, 77 N.C. App. 667, 676-77, 336 S.E.2d 415, 421-22 (1985) (error not to have included goodwill as part of value of the husband's dental practice).

259. *Poore*, 75 N.C. App. at 419, 331 S.E.2d at 270.

260. These methods included an earnings or market approach, a comparable sales approach (the

Particularly worthy of attention, however, are the *Poore* court's observations on goodwill. The court recognized first that, although goodwill may be the most difficult component to value, it would often be the most valuable as well.[261] It therefore discussed, and explained, in some detail various methods that courts might use to determine the dollar value of goodwill.[262] The court declined to evaluate such methods; it concluded instead that "[a]ny legitimate method of valuation that measures the present value of goodwill by taking into account past results, and not the postmarital efforts of the professional spouse, is a proper method of valuing goodwill."[263] Finally, and most significantly, the *Poore* court cautioned that a trial court

> should make specific findings regarding the value of a spouse's professional practice and the existence and value of its goodwill, and should clearly indicate the evidence on which its valuations are based, preferably noting the valuation method or methods on which it relied. On appeal, if it appears that the trial court reasonably approximated the net value of the practice and its goodwill, if any, based on competent evidence and on a sound valuation method or methods, the valuation will not be disturbed.[264]

This is a significant and wholly sensible result. Absent a requirement of findings including the identification and use of recognized methods for determining the value of such an intangible and complex asset as goodwill, there would appear to be no real basis for effective appellate review of such decisions.

However, there was for a time some indication that this standard of review might be considerably relaxed when the value of a closely held, rather than a professional, corporation was at issue. In *Patton v. Patton*[265] the findings of the trial court apparently indicated only that it had considered several different factors in determining the value of the husband's closely held corporation.[266] The

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approach that the wife's expert had in fact used, *id.* at 418-19, 331 S.E.2d at 269-70), offers to buy or sell, and partnership agreements. *Id.* at 419-20, 331 S.E.2d at 270. The court cautioned, however, as had the court in Weaver v. Weaver, 72 N.C. App. 409, 412, 324 S.E.2d 915, 917 (1985), that partnership agreements were not to be deemed conclusive and that other evidence could and should be considered. *See Poore*, 75 N.C App. at 420, 331 S.E.2d at 270.

261. *Poore*, 75 N.C. App. at 420, 331 S.E.2d at 271.

262. *Id.* at 421-22, 331 S.E.2d at 271-72. These methods included the market value approach, capitalization of excess earnings, gross income averages, and sales of comparable practices. There is a wealth of secondary literature on these, and other, methods for valuing professional and closely held corporations. *See, e.g.*, L. GOLDEN, *supra* note 1, § 7.10; Hempstead, *Valuation of a Closely-Held Business*, 2 EQUITABLE DISTRIBUTION REP. 36 (1981); Raggio, *Professional Goodwill and Professional Licenses as Property Subject to Distribution upon Dissolution of Marriage*, 16 FAM. L.Q. 147 (1982); Samuelson, *Putting a Value on a Professional Practice*, 7 FAM. ADVOC. 5 (1984); Welch, *Discovery and Valuation in a Divorce Division Involving a Closely-Held Business or Professional Practice*, 7 COMMUNITY PROP. J. 103 (1980).

263. *Poore*, 75 N.C. App. at 421, 331 S.E.2d at 271.

264. *Id.* at 422, 331 S.E.2d at 272.

265. 78 N.C. App. 247, 337 S.E.2d 607 (1985), *rev'd*, No. 50A86 (N.C. Oct. 7, 1986).

266. *Id.* at 255-56, 337 S.E.2d at 612. One factor that the court had apparently considered was an insurance proposal prepared by the husband in 1980, in which he listed the net value of his business interests at $215,000. *Id.* at 255, 337 S.E.2d at 612. The lower court also apparently "took other relevant facts and circumstances into consideration." *Id.* Thus, it appears that there were fewer findings, and less evidence to support those findings, in *Patton*, in which the valuation was upheld, than in *Poore*, in which it was reversed. *See supra* note 260 and accompanying text.

court of appeals stated that its task on review was to determine "whether *any* competent evidence supported the finding [of] net value" and, with very little discussion, upheld the lower court.[267] The supreme court, however, recently reversed and remanded, taking considerable pain to point out that the statutory "requirement of specific findings is no less applicable in an equitable distribution order involving a spouse's interest in a closely-held corporation."[268]

It would seem that such a distinction would be extremely difficult to justify. Valuation of a closely held corporation may, in reality, be even more complex than valuation of a professional practice. The difficulty that the goodwill intangible presents in the latter instance is not appreciably, if at all, greater than that posed by corporate intangibles such as the right to control. As the supreme court has clearly recognized, the need for a meaningful standard of review is equally acute with either type of enterprise.

As a practical matter valuation of professional or closely held businesses almost will always involve the use of expert witnesses. Indeed, both *Poore* and a subsequent case cautioned lower courts that "[t]he determination of the existence and value of goodwill is a question of fact . . . and should be made with the aid of expert testimony."[269] In addition both cases indicated strongly that courts should, if necessary, exercise their authority to appoint expert witnesses for this purpose, under North Carolina Rule of Evidence 706.[270] Use of this

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267. *Patton*, 78 N.C. App. at 255, 337 S.E.2d at 612 (emphasis added).

268. *Patton*, No. 50A86, slip op. at 3. The supreme court noted also that "[t]he purpose for the requirement of specific findings of fact that support the court's conclusion of law is to permit the appellate court on review 'to determine from the record whether the judgment—and the legal conclusions that underlie it—represent a correct application of the law.' " *Id.* (quoting Coble v. Coble, 300 N.C. 708, 712, 268 S.E.2d 185, 189 (1980)). Moreover, the court noted that "this requirement is not 'designed to encourage ritualistic recitations by the trial court.' " *Id.* (quoting Montgomery v. Montgomery, 32 N.C. App. 154, 158, 231 S.E.2d 26, 29 (1977)). The court concluded that the court of appeals' finding with respect to the value of defendant's interest in the closely held corporation "appears to be merely an enumeration of the factors considered by the trial court in determining [that value]." *Id.* at 4. The court thus remanded for further consideration of that issue. *Id.*

Although not specifically citing it, the supreme court apparently accepted the reasoning of Chief Justice Hedrick's dissent from the court of appeals decision in *Patton*. Judge Hedrick noted:

> I see no reason why the [*Poore* standards] should not apply with equal force to the valuation of an interest in a closely-held corporation . . . . In my opinion, the findings made by the trial court here . . . are not sufficiently specific to enable us to determine whether the trial court reasonably approximated the value of that interest based on competent evidence and on a sound valuation method or methods. A mere finding, such as the one made by the trial court here, that the court has considered several relevant factors or acceptable valuation methods in determining the value of the interest without some greater specificity or indication of the particular evidence or valuation method or methods on which the court relied is not sufficient.

Patton, 78 N.C. App. at 261, 337 S.E.2d at 615-16 (Hedrick, C.J., dissenting).

269. *Poore*, 75 N.C. App. at 421, 331 S.E.2d at 271; *see also* Dorton v. Dorton, 77 N.C. App. 667, 676-77, 336 S.E.2d 415, 422 (1985) (valuation of goodwill of dental practice requires expert testimony).

270. *See* Dorton v. Dorton, 77 N.C. App. 677, 676-77, 336 S.E.2d 415, 422 (1985); *Poore*, 75 N.C. App. at 421, 331 S.E.2d at 271. Rule 706(a) provides in part that "[t]he court may on its own motion or on the motion of any party enter an order to show cause why expert witnesses should not be appointed . . . . The court may appoint any expert witness agreed upon by the parties, and may appoint witnesses of its own selection." N.C.R. EVID. 706(a) (Supp. 1985).

rule in such a fashion would be highly unusual.[271] The suggestion does nonetheless offer some interesting possibilities.

The ultimate cost of any valuation testimony presented by a court-appointed expert witness would, of course, be borne by the parties, "in such proportion and at such time as the court directs, and thereafter charged in like manner as other costs."[272] Presumably, of course, court appointed experts would be unnecessary in most circumstances.[273] There are instances, however, when one party may successfully frustrate the efforts of the other to discover the wealth of information necessary for goodwill valuations.[274] Rule 706 would thus appear to create, at least in theory, the possibility that a court might appoint its own expert, upon proof that such obstructionist behavior had occurred, and assess the fees for such testimony against the party whose behavior had largely created the need for the expert in the first instance.[275]

Such an eventuality, however, is unlikely. This is true in part because it does not appear that rule 706 was designed to function as any kind of sanction for obstructionist behavior. More significantly, however, discovery sanctions are available under North Carolina Rule of Civil Procedure 37.[276] Unfortunately, it appears that despite the urging of appellate courts, lower courts have been unwilling even to employ that remedy against parties who fail to comply with pretrial discovery requests.[277]

The general problem raised by this discussion does point out one of the most serious deficiencies of the North Carolina statute. The statute makes virtually no provision for the recovery of fees or costs incurred by a party who is without "sufficient funds to defray the expense" of pursuing an equitable distribution claim, and thus cannot meet his or her spouse on an "equal footing."[278] The quoted language does, of course, constitute the well-established rationale

271. The rule was adopted in 1983 as part of North Carolina's adoption of the Federal Rules of Evidence. Apparently it has been virtually unused, in this or any other context.

272. N.C.R. EVID. 706(b) (Supp. 1985).

273. Rule 706 clearly could not be used, for example, in situations in which a party simply fails to procure or present evidence on goodwill.

274. *See, e.g.*, Wilson v. Wilson, 73 N.C. App. 96, 325 S.E.2d 668 (1985) (husband had refused to comply with interrogatories); Wade v. Wade, 72 N.C. App. 372, 325 S.E.2d 260 (1985) (husband had rendered discovery virtually useless by his successful efforts to conceal or convert marital property).

275. The statement in *Wade* that a court "may not . . . punish plaintiff by considering his misconduct during litigation as a factor" should not prohibit such a result. *Wade*, 72 N.C. App. at 377, 325 S.E.2d at 266. This is true, first, because *Wade's* strictures were directed against use of the husband's conduct as a distributive factor. *Id.* More significantly, the supreme court's decision in Smith v. Smith, 314 N.C. 80, 331 S.E.2d 682 (1985) (allowing consideration of such economic fault) and the addition of N.C. GEN. STAT. § 50-20(c)(11a) (Supp. 1985) (detailing the types of economic conduct that may be considered at the distributive stage) seem to have overruled *Wade* on this issue.

276. N.C.R. CIV. P. 37 (1983 & Supp. 1985). The rule provides for orders compelling discovery, for assessment of attorneys' fees against the party who necessitated the order if the order is granted, and for contempt sanctions under certain circumstances.

277. Wilson v. Wilson, 73 N.C. App. 96, 101, 325 S.E.2d 668, 671 (1985); *Wade*, 72 N.C. App. at 377, 325 S.E.2d at 266.

278. Section 50-20(i), as discussed *supra* note 79, does make an extremely limited provision for the recovery of fees and costs incurred in recovering separate property that was wrongfully removed from possession, so long as such fees do not exceed the value of that property. N.C. GEN. STAT. § 50-20(i) (Supp. 1985). By its very recognition that legal expenses may exceed the value of property

under which attorneys' fees have long been provided for in actions for alimony, alimony pendente lite, child support, and custody.[279] That same well-founded rationale is no less, and indeed is probably considerably more pressing with equitable distribution claims.

In complicated cases, and particularly in those requiring the use of experts and appraisals, the financially weaker spouse will almost inevitably be at some disadvantage in pursuing his or her claim. When the majority of assets are titled in the name of one spouse, moreover, or when that spouse is able and willing to inflate the expenses of the other—as with dilatory discovery tactics—the expenses of litigation may be prohibitive. The partnership marriage concept can thus be reduced to a mockery, if the parties may, in effect, be forced to forfeit their partnership rights due to substantial economic inequality before trial.

The problem in North Carolina has, however, been considerably ameliorated by the recent case of *In re Cooper*[280] in which the court held that contingent fee contracts for services in equitable distribution proceedings are enforceable, so long as no part of the compensation is based upon procuring a divorce.[281] The decision is a practical and necessary response to the stark fact of economic inequality that exists between most husbands and wives. It will do much to help guarantee that such financial disparities do not become the controlling factor in equitable distribution litigation.

Similar considerations have led a large number of states to provide for recovery of attorneys' fees and costs incurred in equitable distribution litigation.[282] New York, whose statute most closely resembles that of North Carolina, has gone so far as to interpret its pendente lite statute to provide for the allowance of attorneys' fees in an equitable distribution action.[283] Several

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sought to be protected, this less than generous provision serves as ironic testimony to the need for greater allowances for attorneys' fees and costs.

279. *See* N.C. GEN. STAT. § 50-13.6 (1984) (counsel fees in actions for custody and support of minor children); *id.* § 50-16.3 to 16.4 (counsel fees in actions for alimony); *see also* Quick v. Quick, 305 N.C. 446, 290 S.E.2d 653 (1982) (award of counsel fees in alimony action must be based on sufficient factual findings); Hudson v. Hudson, 299 N.C. 465, 263 S.E.2d 719 (1980) (award of attorneys' fees in custody or support suit proper when party acts in good faith and lacks the means to pay the cost of the suit); Little v. Little, 12 N.C. App. 353, 183 S.E.2d 278 (1971) (alimony pendente lite and associated counsel fees are matters of substantive right).

280. 81 N.C. App. 27, 344 S.E.2d 27 (1986).

281. *Id.* at 41, 344 S.E.2d at 31. *In re* Cooper should be distinguished from Thompson v. Thompson, 70 N.C. App. 147, 319 S.E.2d 315 (1984), *rev'd on other grounds*, 313 N.C. 313, 328 S.E.2d 288 (1985), in which the court of appeals noted that "a contract for the payment of a fee to an attorney contingent upon the securing of a separation or divorce or contingent in amount upon the amount of alimony, support or property settlement obtained is void as against public policy." *Id.* at 149, 319 S.E.2d at 317. *Thompson*, however, was not an equitable distribution case.

282. *See* COLO. REV. STAT. § 14-10-119 (Supp. 1985); CONN. GEN. STAT. ANN. § 46b-62 (West Supp. 1986); DEL. CODE ANN. tit. 13, § 1515 (1981); FLA. STAT. ANN. § 61.16 (West 1984); HAWAII REV. STAT. § 580-47(e) (Supp. 1984); ILL. ANN. STAT. ch. 40 ¶ 508(a)(1) (Smith-Hurd Supp. 1986); IND. CODE ANN. § 31-1-11.5-16 (Burns Supp. 1986); KAN. STAT. ANN. § 60-1610(b)(4) (1985); KY. REV. STAT. ANN. § 403.220 (Michie/Bobbs-Merrill 1984); MASS. ANN. LAWS ch. 208, § 38 (Law. Co-op. 1981); MINN. STAT. ANN. § 518.14 (West Supp. 1986); MO. ANN. STAT. § 452.355 (Vernon 1977); MONT. CODE ANN. § 40-4-110 (1985); S.C. CODE ANN. § 20-3-140 (Law. Co-op. 1985); UTAH CODE ANN. § 30-3-3 (1984).

283. *See, e.g.*, Hinden v. Hinden, 122 Misc. 2d 552, 472 N.Y.S.2d 248 (1983) (temporary award of attorneys' fees); Gueli v. Gueli, 106 Misc. 2d 877, 435 N.Y.S.2d 537 (1981) (fee awarded for accounting services to be obtained by plaintiff's attorney).

states have also allowed fee awards to one spouse when the other spouse attempted to conceal assets or otherwise impede discovery.[284] The latter solution, when additional expenses of pretrial discovery may be charged against a party who, without good cause, created the necessity for such expenses, would appear to be a particularly appropriate means of addressing one of the more egregious effects of disparate economic power.

The other side of the valuation issue is that discovery requests may be so extensive as to create unreasonable, or even unethical, compliance burdens for the corporate or professional spouse. Determining the appropriate scope of discovery has proved to be a rather troublesome issue in other states.[285] And although this issue has not yet arisen in the North Carolina appellate courts in an equitable distribution context, the case of *Quick v. Quick*,[286] which involved the use of discovery for alimony purposes, does set forth, in general terms, the factors a court must balance to arrive at a resolution of this issue.[287] The court in *Quick* allowed the use of a subpoena *duces tecum* to obtain the corporate records of a closely held corporation. The supreme court overruled the husband's motion to quash, noting that "where a substantial portion of a party's total worth is stock in a closely held corporation, certain information from the corporation's business records" can be an appropriate object of a subpoena *duces tecum*.[288] It cautioned, however, that "mere fishing expeditions" would not be allowed.[289] Courts in other jurisdictions have developed guidelines for drawing more precise lines between fishing expeditions designed to harass and genuine searches for relevant and necessary information[290] and these guidelines will undoubtedly be of considerable use to North Carolina courts in the future.

In summary, it seems that North Carolina has experienced relatively few analytical problems with the valuation stage of equitable distribution. Although many of the practical problems associated with discovery and the use of experts remain unaddressed, the general principles controlling the valuation process are relatively clear. Judicial discretion is the hallmark of this entire area. Meaningful and practical restraints on the exercise of that discretion that have been developed for valuation of professional practices have clearly been extended to other complex business enterprises. It is critical, however, that courts use all

284. *See, e.g.*, Donahue v. Donahue, 134 Mich. App. 696, 352 N.W.2d 705 (1984) (wife awarded fees when the husband attempted to conceal assets); Quade v. Quade, 367 N.W.2d 87 (Minn. Ct. App. 1985) (wife awarded fees when the husband attempted to conceal assets).

285. *See, e.g.*, Kaye v. Kaye, 102 A.D.2d 682, 478 N.Y.S.2d 324 (1984) (permitting discovery of financial information regarding a closely held corporation in which defendant was a minority shareholder); Lee v. Lee, 93 A.D.2d 221, 462 N.Y.S.2d 34 (1983) (per curiam) (allowing discovery of financial records of the husband's law firm previously furnished to him); Stolowitz v. Stolowitz, 106 Misc. 2d 853, 435 N.Y.S.2d 882 (1980) (refusing to allow discovery of lawyer husband's client list).

286. 305 N.C. 446, 290 S.E.2d 653 (1982).

287. *Id.* at 455-56, 290 S.E.2d at 662.

288. *Id.* at 460, 290 S.E.2d at 662.

289. *Id.*

290. *See* Kaye v. Kaye, 102 A.D.2d 682, 478 N.Y.S.2d 324 (1984); Lee v. Lee, 93 A.D.2d 221, 462 N.Y.S.2d 34 (1983) (per curiam); Stolowitz v. Stolowitz, 106 Misc. 2d 853, 435 N.Y.S.2d 882 (1980); Welch, *supra* note 252, at 108.

means within their disposal to prevent attempts to obstruct discovery and to minimize the effects of economic disparity between the parties.

VI. DISTRIBUTION OF MARITAL PROPERTY

A. *Equal vs. Equitable*

The integrity of each stage of equitable distribution clearly depends on the stage, or stages, preceding it, so that accurate classification and valuation are absolute predicates to any fair distributive result. The final stage, the distributive stage, of the process also depends on two other factors. Like valuation, distribution is heavily committed to a judicious exercise of discretion at the trial court level. Much like classification, moreover, distribution must be undertaken within the context of the overall partnership and remedial goals of the statute. Indeed, these principles constitute the very foundation of the distributive process: the statute itself, in contrast to the statutes of most other states,[291] requires that "[t]here shall be an equal division . . . of marital property unless the court determines that an equal division is not equitable."[292]

This initial presumption that an equal distribution of marital property is equitable is an almost literal embodiment of the partnership concept.[293] But in *White v. White*[294] the supreme court interpreted the effect of the statutory language even more strongly: it was, the court held, a "legislative enactment of public policy so strongly favoring the equal division of marital property that an equal division is made *mandatory* 'unless the court determines that an equal division is not equitable.' "[295] Significantly, as the supreme court explained in further detail in a subsequent case, this equal division presumption is in turn founded on a correlative presumption that both spouses contributed equally, albeit differently, to acquisition of the partnership assets in the first instance.[296]

On the other hand, if a trial court determines that an equal division would not be equitable, the statute directs that the marital property be divided "equitably."[297] It then sets out thirteen factors, including "[a]ny other factor which the court finds to be just and proper," that a court "shall consider under this subsec-

291. Only two other states have similar statutory provisions. *See* Sharp, *supra* note 6, at 250.

292. N.C. GEN. STAT. § 50-20(c) (Supp. 1985).

293. Not surprisingly, North Carolina courts were quick to point out that the statutory language does create such a presumption. *See, e.g.*, Loeb v. Loeb, 72 N.C. App. 205, 215, 324 S.E.2d 33, 41 (compelling reasons necessary to rebut the equal distribution presumption), *cert. denied*, 313 N.C. 508, 329 S.E.2d 393 (1985); Alexander v. Alexander, 68 N.C. App. 548, 553, 315 S.E.2d 772, 776 (1984) (unequal division "justified only if facts . . . exist which compel the conclusion that equal would not be equitable"); White v. White, 64 N.C. App. 432, 436, 308 S.E.2d 68, 71 (1983) (statute establishes presumption of equal division), *modified and aff'd*, 312 N.C. 770, 324 S.E.2d 829 (1985).

294. 312 N.C. 770, 324 S.E.2d 829 (1985).

295. *Id.* at 776, 324 S.E.2d at 832 (quoting N.C. GEN. STAT. § 50-20(c) (Supp. 1985)). The court noted further that the presumption could only be overcome by a preponderance of the evidence. *Id*; *see also* Smith v. Smith, 314 N.C. 80, 86, 331 S.E.2d 682, 686 (1985) (discussing a correlative presumption that both spouses contributed equally to the partnership assets).

296. Smith v. Smith, 314 N.C. 80, 85-86, 331 S.E.2d 682, 686 (1985). *White* had also relied on a legislative intention to implement partnership principles and to remedy the inequitable effects of a title only scheme upon homemaker spouses. *White*, 312 N.C. at 773-75, 324 S.E.2d at 831-32.

297. N.C. GEN. STAT. § 50-20(c) (Supp. 1985).

tion."[298] This last section created some confusion whether courts were to consider the statutory factors in the initial determination of whether "equal" would be "equitable," or only in determining what would constitute an equitable, unequal division. The only common sense result, as the supreme court implicitly concluded in *Smith v. Smith*,[299] is that the factors be considered in each instance; certainly "the trial court is required to consider all . . . factors listed in the statute when determining whether an equal division of marital property is equitable."[300]

This seemingly obvious point takes on added significance in light of an issue that has arisen in connection with the further statutory requirement that a court must make "written findings of fact that support the determination that the marital property has been equitably divided."[301] The combination of this requirement with the strong presumption in favor of equal divisions of property led courts easily to the conclusion that specific findings of fact are necessary to support an unequal division of property.[302] The same logic led courts to conclude, perhaps too easily, that equal divisions of property would not require specific findings of fact.[303] Early appellate decisions upholding equal divisions that were arguably less than equitable,[304] and the enunciation of a rather strict standard of review by the supreme court,[305] appeared to confirm this conclusion.

The principle that equal divisions of property need not be supported by specific findings of fact must be qualified, however, by the requirement that a court must have adequately considered statutory and nonstatutory[306] factors

298. *Id.* § 50-20(c)(1)-(12).

299. 314 N.C. 80, 331 S.E.2d 682 (1985).

300. *Id.* at 88, 331 S.E.2d at 687.

301. N.C. GEN. STAT. § 50-20(j) (1984).

302. *See, e.g.*, Andrews v. Andrews, 79 N.C. App. 228, 232, 338 S.E.2d 809, 812 (1986); Weaver, v. Weaver, 72 N.C. App. 409, 416-18, 324 S.E.2d 915, 920-21 (1985); Loeb v. Loeb, 72 N.C. App. 205, 217, 324 S.E.2d 33, 42, *cert. denied*, 313 N.C. 508, 329 S.E.2d 393 (1985).

303. *See, e.g.*, Andrews v. Andrews, 79 N.C. App. 228, 232, 338 S.E.2d 809, 812 (1986); Weaver v. Weaver, 72 N.C. App. 409, 416-18, 324 S.E.2d 915, 920-21 (1985); Loeb v. Loeb, 72 N.C. App. 205, 217, 324 S.E.2d 33, 42, *cert. denied*, 313 N.C. 508, 329 S.E.2d 393 (1985). In White v. White, 312 N.C. 770, 324 S.E.2d 829 (1985), the supreme court also noted that a "specific statement that the [equal] distribution ordered is equitable is not required." *Id.* at 778, 324 S.E.2d at 834. The court of appeals, however, has indicated that such a specific finding is to be preferred. *See* Ellis v. Ellis, 68 N.C. App. 634, 637, 315 S.E.2d 526, 528 (1984).

304. In *White* the supreme court upheld an equal division in circumstances wherein the homemaking, child-rearing, and compensated employment contributions of a wife of 32 years could easily have led many courts to have required an unequal division in her favor: "we cannot say that the evidence fails to show any rational basis for the distribution ordered by the court." *White*, 312 N.C. at 778, 324 S.E.2d at 833. And in Loeb v. Loeb, 72 N.C. App. 205, 324 S.E.2d 33, *cert. denied*, 313 N.C. 508, 329 S.E.2d 393 (1985), an equal division of property was upheld despite the fact the majority of the marital property had been derived from gifts from the wife's mother, *id.* at 207-08, 324 S.E.2d at 36-37, the husband had considerable vested pension rights (which were separate property under the original version of the Act applicable to the case), and the husband's income was $50,000 per year while the wife's was $7,000. *Id.* at 215, 324 S.E.2d at 41. The wife also had custody of the minor children. *Id.* at 216, 324 S.E.2d at 42.

305. In *White* the supreme court enunciated a very limited standard of review: "[a] ruling committed to a trial court's discretion is to be accorded great deference and will be upset only upon a showing that it was so arbitrary that it could not have been the result of a reasoned decision." *White*, 312 N.C. at 777, 324 S.E.2d at 833.

306. The statute itself, of course, directs that nonspecified factors should be considered. N.C.

that could have led to an unequal distributive determination.[307] The practical effect of this is that even equal divisions of property will not survive appellate review unless it is clear that the entire pool of marital *and* separate assets was properly identified in the first instance. Failure to identify marital property fully is, of course, an obvious violation of an explicit statutory requirement,[308] and will always constitute reversible error.[309] It must be emphasized, however, that failure to identify all separate property, even within the context of an equal division, will have the same effect.[310] In *Poore v. Poore*,[311] for example, the trial court had ordered an equal division of marital property and had also found that the husband had no separate property. The court of appeals reversed, on the grounds that the husband's license to practice dentistry and his retirement benefits were separate property and thus should have been considered in the determination of whether an equal division would in fact be equitable.[312] Several other cases have reached the same result.[313]

Thus, although there is no specific statutory requirement that all separate property be identified with either equal or unequal divisions of property, it is clear that such identification is required, implicitly by the statute itself, and explicitly by the courts. Failure to identify separate property is, on its face, proof that a court could not have considered all the necessary factors in reaching a determination that an equal division would be equitable. And although it may be literally true that specific findings of fact are not necessary to support equal divisions of property, the better course of valor undoubtedly is that all divisions of property be supported by findings that all property, both marital and separate, has been identified and considered. At least one court has recognized this as the

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GEN. STAT. § 50-20(c)(12) (Supp. 1985). For a fuller discussion of factor (12), see *infra* notes 324-26 & 334 accompanying text.

307. *See supra* text accompanying notes 297-300.

308. N.C. GEN. STAT. § 50-20(c) (Supp. 1985).

309. *See, e.g.*, Little v. Little, 74 N.C. App. 12, 17-18, 327 S.E.2d 283, 288 (1985) (court "neglected entirely to list, value, or award the second house and lot" and failed to state whether a van and various bank accounts were marital property); Weaver v. Weaver, 72 N.C. App. 409, 418, 324 S.E.2d 915, 921 (1985) (equal division reversed for failure to have included personal property items as part of marital property); Brown v. Brown, 72 N.C. App. 332, 336, 324 S.E.2d 287, 290 (1985) (error not to have identified and distributed automobile as marital property).

310. This is a logical, if not immediately obvious, conclusion. A court clearly cannot consider the statutory factors in determining *whether* an equal division would be equitable without, at a minimum, having knowledge of the full extent of the marital and separate estates.

311. 75 N.C. App. 414, 331 S.E.2d 266 (1985).

312. *Id.* at 423-24, 331 S.E.2d at 272-73.

313. *See, e.g.*, Dorton v. Dorton, 77 N.C. App. 667, 670, 336 S.E.2d 415, 418 (1985), in which the court of appeals held that the lower court's finding that there was no separate property was "error on the face" of the record, because the husband's dental license was separate property and because N.C. GEN. STAT. § 50-20(c)(1) (Supp. 1985) "requires the trial court to consider the property of each party when making a property division." In Talent v. Talent, 76 N.C. App. 545, 334 S.E.2d 256 (1985), the court of appeals reversed an equal division of marital property on the ground, among others, that the trial court had not considered "the separate property owned by each party at the time the property division is to become effective." *Id.* at 555, 334 S.E.2d at 263; *see also* Nix v. Nix, 80 N.C. App. 110, 113, 341 S.E.2d 116, 118 (1986) (trial court must identify all property owned by the parties and then classify each item as separate or marital); Dewey v. Dewey, 77 N.C. App. 787, 791, 336 S.E.2d 451, 454 (1985) (upholding an equal division, but noting that the trial court had been "required" to consider the husband's separate property pension benefits).

appropriate course of action.[314]

Considerably more detailed findings of fact are required to support unequal divisions of property.[315] Although such findings need not address each of the thirteen statutory factors specifically,[316] such findings must address all relevant factors.[317] The weight to be assigned any particular factor is, of course, within the discretion of the trial court,[318] and even a single finding, based on competent evidence, may suffice to support an unequal division of property.[319]

In general, it appears that the broad principles governing the distributive stage are relatively clear. Unequal divisions of marital property must be carefully supported by specific findings of fact as to all relevant statutory and nonstatutory factors, because such results contravene the strong statutory presumption that equal is equitable. Equal divisions, on the other hand, are much more likely to survive appellate review, but it appears that even these orders must at least indicate that the court considered appropriate factors. Equal divisions must therefore be based on a full identification of both marital and separate assets.

Judicial discretion is, of course, the hallmark of the distributive process. The exercise of that discretion is limited by the "equal is equitable" presumption: it should be guided, above all, by the fundamental equitable and remedial principles that underlie the statute. It should also be guided by consideration of statutory, and certain types of consistent nonstatutory factors.[320]

B. *Distributional Factors*

North Carolina General Statute section 50-20(c) sets forth a rather detailed,

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314. *See* Talent v. Talent, 76 N.C. App. 545, 555, 334 S.E.2d 256, 263 (1985) (trial court should have made a finding indicating its consideration of the wife's separate property).

315. The earliest case on point, Alexander v. Alexander, 68 N.C. App. 548, 315 S.E.2d 772 (1984), set out the requirement clearly: "the trial court should clearly set forth in its order findings of fact based on the evidence which support its conclusion that an equal division is not equitable." *Id.* at 552, 315 S.E.2d at 776; *see also* Little v. Little, 74 N.C. App. 12, 18-19, 327 S.E.2d 283, 289 (1985) (reversing unequal award in favor of disabled husband after trial court had failed to consider monthly expenses, expectation of pension rights, need of custodial parent to occupy the home, etc.); Wade v. Wade, 72 N.C. App. 372, 376-77, 325 S.E.2d 260, 266 (1985) (reversing unequal division for failure to find facts in support thereof); Loeb v. Loeb, 72 N.C. App. 205, 217, 324 S.E.2d 33, 42 (stating in dicta that "the trial court need only make findings of fact . . . to support its conclusion that an equal distribution is inequitable"), *cert. denied*, 313 N.C. 508, 329 S.E.2d 393 (1985).

316. Andrews v. Andrews, 79 N.C. App. 228, 233, 338 S.E.2d 809, 813 (1986) (some of the factors were not relevant, some had been the subject of stipulations, and failure of the lower court to make specific findings as to each of the factors did not affect the substantive rights of the parties); *see also* Patton v. Patton, 78 N.C. App. 247, 257, 337 S.E.2d 607, 613 (1985) (a 58/42 division in favor of wife upheld, when court attempted to consider all factors and did consider, and make findings of fact with regard to, seven of the factors), *rev'd on other grounds*, No. 50A86 (N.C. Oct. 7, 1986).

317. Andrews v. Andrews, 79 N.C. App. 228, 232, 338 S.E.2d 809, 812 (1986). A trial court's mere statement that it had considered such factors will not suffice. *See* Brown v. Brown, 72 N.C. App. 332, 336, 324 S.E.2d 287, 289-90 (1985) (reversing a 45/55 division for failure to articulate specific reasons therefor).

318. White v. White, 312 N.C. 770, 777, 324 S.E.2d 829, 833 (1985).

319. Andrews v. Andrews, 79 N.C. App. 228, 235, 338 S.E.2d 809, 814 (1986) (citing, as an example, the chronic disability of one spouse); Bradley v. Bradley, 78 N.C. App. 150, 154, 336 S.E.2d 658, 660-61 (1985) (disparity in income alone is sufficient to justify unequal division).

320. *See infra* note 334 and accompanying text.

and sometimes quite confusing, list of thirteen distributive factors.[321] But before undertaking any detailed discussion of particular factors, three general points must be borne in mind. First, it appears that a trial court must take these factors into consideration both when making the initial determination whether the equal presumption has been rebutted, and, if necessary, in determining what type of nonequal division would be equitable.[322] Second, consideration of these factors must be strictly limited to this third stage of the equitable distribution proceeding.[323] Interjection of distributive factor considerations into the classification stage, in particular, poses very real dangers that the "economic contribution" purpose of the statute might be undermined by facts that are extraneous to a determination of what is marital property.

Last, the statutory list of factors is by no means exclusive: the inclusion of "[a]ny other factor which the court finds to be just and proper" is clearly a broad directive that courts consider other factors that are consistent with the general policies and purposes of the statute.[324] Although the reach of this

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321. N.C. GEN. STAT. § 50-20(c) (Supp. 1985).

> There shall be an equal division by using net value of marital property unless the court determines that an equal division is not equitable. If the court determines that an equal division is not equitable, the court shall divide the marital property equitably. Factors the court shall consider under this subsection are as follows:
>
> (1) The income, property, and liabilities of each party at the time the division of property is to become effective;
>
> (2) Any obligation for support arising out of a prior marriage;
>
> (3) The duration of the marriage and the age and physical and mental health of both parties;
>
> (4) The need of a parent with custody of a child or children of the marriage to occupy or own the marital residence and to use or own its household effects;
>
> (5) The expectation of nonvested pension, retirement, or other deferred compensation rights, which is separate property;
>
> (6) Any equitable claim to, interest in, or direct or indirect contribution made to the acquisition of such marital property by the party not having title, including joint efforts or expenditures and contributions and services, or lack thereof, as a spouse, parent, wage earner, or homemaker;
>
> (7) Any direct or indirect contribution made by one spouse to help educate or develop the career potential of the other spouse;
>
> (8) Any direct contribution to an increase in value of separate property which occurs during the course of the marriage;
>
> (9) The liquid or nonliquid character of all marital property;
>
> (10) The difficulty of evaluating any component asset or any interest in a business, corporation, or profession, and the economic desirability of retaining such asset or interest, intact and free from any claim or interference by the other party;
>
> (11) The tax consequences to each party;
>
> (11a) Acts of either party to maintain, preserve, develop, or expand; or to waste, neglect, devalue, or convert such marital property, during the period after separation of the parties and before the time of distribution; and
>
> (12) Any other factor which the court finds to be just and proper.

Id.

322. *See supra* note 310 and accompanying text.

323. *See supra* note 32 and accompanying text.

324. N.C. GEN. STAT. § 50-20(c)(12) (Supp. 1985); *see also* Loeb v. Loeb, 72 N.C. App. 205, 215, 324 S.E.2d 33, 41 (finding no claim under relevant statute), *cert. denied*, 313 N.C. 508, 329 S.E.2d 393 (1985); Alexander v. Alexander, 68 N.C. App. 548, 552, 315 S.E.2d 772, 775 (1984) (court must consider any statutory or nonstatutory factor "raised by the evidence which is reasonably related to the rights to, interest in, and need for the marital property").

"catch-all" factor has not been, and indeed is not likely to be, determined with precision, it is important to note that factor (12) is not a "wild card" for the exercise of unfettered judicial discretion. In particular, the supreme court has imposed one very broad and quite significant limitation on its operation. In *Smith v. Smith*[325] the court confronted the critical question of the role of fault as a distributive consideration under factor (12) and concluded that "marital fault or misconduct of the parties which is not related to the economic condition of the marriage is not germane to a division of marital property . . . and should not be considered."[326]

Because it has relevance far beyond the fault context, the *Smith* analysis must be examined in some detail. The court reasoned first that elimination of traditional "marital" fault as a consideration was consistent with the thrust and purpose of the remainder of the statutory factors, all of which relate in some fashion to the "marital economy."[327] Most significantly, the court recognized that consideration of such marital fault would be totally inconsistent with the fundamental economic partnership principles and with the "repayment of contribution" rationale on which the North Carolina statute was based.[328] Conduct that was irrelevant to the accumulation of marital assets should be equally irrelevant to the ultimate distribution of such assets.

The logical counterpart to such reasoning requires, on the other hand, that "fault" which does relate to the economy of the marriage is a just and proper factor for consideration at the distributional stage.[329] Thus, *Smith* also concluded that spousal conduct that "dissipates or reduces marital property for nonmarital purposes" may be considered.[330] The resulting distinction between "economic" and "marital" fault is an almost perfect reflection of the function and purpose of the "economic contribution" rationale on which the statute itself

325. 314 N.C. 80, 331 S.E.2d 682 (1985).

326. *Id.* at 87, 331 S.E.2d at 687. The court of appeals had come to the same conclusion in Hinton v. Hinton, 70 N.C. App. 665, 666-70, 321 S.E.2d 161, 162-64 (1984). The supreme court also reaffirmed this holding in Dusenberry v. Dusenberry, 314 N.C 608, 609, 335 S.E.2d 892, 892-93 (1985), in which it held that the lower court had erroneously considered evidence of the wife's adultery as a distributive factor.

327. *Smith*, 314 N.C. at 86-87, 331 S.E.2d at 686-87.

328. *Id.* at 87, 331 S.E.2d at 687; *see also* Hinton v. Hinton, 70 N.C. App. 665, 668-69, 321 S.E.2d 161, 163 (1984), in which the court also pointed out that a contrary result would "give courts the inherently arbitrary power to place a monetary value on the misconduct of a spouse in dividing property." The effect, almost inevitably, would be to turn the statute into a punitive device, a result that is totally inconsistent with partnership principles.

329. *Smith*, 314 N.C. at 88, 331 S.E.2d at 687. This consideration of economic fault is thus significantly broader than that specified in N.C. GEN. STAT. § 50-20(c)(11a) (Supp. 1985). The statute allows only economic misconduct that occurred between the date of separation and the date of distribution to be considered as a distributive factor.

330. *Smith*, 314 N.C. at 88, 331 S.E.2d at 687. Significantly, the court gave as an example of such economic fault "the conveyance by one spouse of marital assets in contemplation of divorce." *Id.* Moreover, the court identified the *use* of marital property for "nonmarital" purposes as wrongful conduct under this section. *Id.* Thus, it may be reasonable to conclude that the supreme court has implicitly limited the scope of economic fault to include only conduct that was in derogation of marital rights. Such a limitation would have the distinct advantage of eliminating from consideration the personal attributes of a party—such as tendencies to engage in speculative or unwise investments, laziness, inability to keep a job, etc.—that would nonetheless have had an impact on the overall marital economy.

is based.[331] Moreover, it should be noted that the distinction is essentially functional, not semantic. The appropriate inquiry would seem to focus, not on the type of conduct per se, but rather on whether such misconduct was undertaken in derogation of, and had an adverse effect on, the marital economy. Thus, improperly motivated conduct that has a demonstrably adverse effect on the pool of marital assets probably should be considered under this section, regardless of the nature of such conduct.[332]

It is also reasonable to suggest that the functional, marital economy type of analysis the *Smith* court used constitutes an excellent framework for further development of the "catch-all" factor. Indeed, the *Smith* criteria could, and should, provide the substantive test for consideration of any nonstatutory factor. Thus, nonstatutory factors that are consistent with the general economic contribution purposes of the statute and with the other twelve distributional factors, and that are not based on traditional notions of marital or moral fault, should properly be considered at the distributional stage. An interesting and very good example of such an approach is *Johnson v. Johnson*,[333] in which the court of appeals concluded, on the basis of the *Smith* rationale, that the lower court had properly considered the decrease in value of the wife's separate property, from which most of the income of the parties had been derived during the marriage, as a factor supporting an unequal division in favor of the wife.[334]

Within this context, it may be useful to note that the remaining statutory factors can, at least in a rough if somewhat overlapping fashion, be broken down into three general categories: (1) factors that focus on the current and future condition and needs of the spouses and their children; (2) factors that can be regarded as basically compensatory, in that they reflect some attempt to com-

331. The attribution, by the dissent in Dusenberry v. Dusenberry, 314 N.C. 608, 615, 335 S.E.2d 892, 895-96 (1985) (Meyer, J., dissenting), of a contrary conclusion to this author is mistaken. The language quoted by the dissent in fact derives from a very fine student note, which drew the "economic" versus "marital" fault distinction, and argued forcefully for the irrelevancy of the latter as a factor in distribution. *See* Note, *The Discretionary Factor in the Equitable Distribution Act*, 60 N.C.L. REV. 1399 (1982).

332. Thus, for example, although adultery by a spouse clearly should be irrelevant to the distribution of property, that a spouse depleted the marital estate by making expensive gifts to the paramour might well be considered as an appropriate distributive factor. Similiarly, it would appear that traditional "moral fault"—physical abuse by the husband in this case—that has an economic effect (reduced earning capacity for wife as a result of eye injuries inflicted by husband) could well be considered under the *Smith* rationale. *See* Hinton v. Hinton, 70 N.C. App. 665, 673, 321 S.E.2d 161, 165-66 (1985) (Becton, J., dissenting).

333. 78 N.C. App. 787, 338 S.E.2d 567 (1986).

334. *Id.* In fact the court concluded that the marital estate had been increased in value at the expense of the separate estate. On the other hand, a considerably more questionable result with factor (12) was reached in Dorton v. Dorton, 77 N.C. App. 667, 679, 336 S.E.2d 415, 423 (1985), in which the court concluded that "it is certainly within the trial court's equitable powers to consider that one spouse worked outside the home *and* participated in child-rearing and homekeeping while the other spouse *only* participated in child-rearing and homekeeping." Such a statement is reminiscent of the kind of denigration of "mere" homemaking, which the act was specifically designed to remedy. It is doubtful if the division of household chores should in any case, be an appropriate distributional factor. It is even more doubtful that such facts are sufficient to rebut the presumption that spousal contributions are equal. *See supra* text accompanying note 20. Finally, it should be noted that the parties in *Dorton* had been married 27 years and had five children. *Dorton*, 77 N.C. App. at 668, 336 S.E.2d at 417. That the husband contributed to household and child-rearing efforts under such circumstances seems hardly to warrant a "credit" for equitable distribution purposes.

pensate one spouse for property that is otherwise excluded from the definition of marital property; and (3) factors that allow consideration of the nature of the particular asset being distributed.

The "need and condition" category clearly encompasses factors (1) through (4), all of which deal explicitly with the personal and financial circumstances of the parties at the time of distribution and, implicitly, with their future circumstances as well.[335] More often than not, these factors will be closely related to the contributions, monetary or otherwise, made to the marriage by the spouses.[336] It is also important to note that these four factors look, both implicitly and explicitly, to the future needs and conditions of the parties as well[337]—needs that are, particularly in the case of a homemaker spouse, often a direct result of an investment in "marriage-specific" rather than career assets.[338]

It appears that the most critical determinants of future need are the extent of a party's separate property at the time of distribution, and his or her future earning capacity. As noted earlier, the court of appeals repeatedly has emphasized the necessity of considering the separate property[339] and income[340] of each

335. *See supra* note 321 (listing the statutory factors).

336. In particular, spouses who have devoted their efforts to homemaking or child-rearing throughout a marriage are likely to be severely disadvantaged in the work force as a direct result of their marital contributions. See *supra* note 28 and accompanying text for a discussion of how ill-served such spouses are in the majority of equitable distribution regimes.

337. Factor (4), addressing the "need of a parent with custody . . . to occupy or own the marital residence," directly speaks to future needs, of course. N.C. GEN. STAT. § 50-20(c)(4) (Supp. 1985). Moreover, when there is sufficient marital property to avoid a forced sale of the marital home, it appears that this factor is a common sense directive that the home be awarded to the custodial parent. *See, e.g.* Andrews v. Andrews, 79 N.C. App. 228, 233, 338 S.E.2d 809, 813 (1986). Whether this factor will be used, as it almost certainly should be, to justify an unequal division in favor of the custodial parent to avoid a forced sale of the marital home remains to be seen. *See supra* note 29; *see also* Little v. Little, 74 N.C. App. 12, 19, 327 S.E.2d 283, 289 (1985), in which the court remanded an unequal division in favor of the non custodial parent on the ground, among others, that the lower court had failed to consider this factor in its distribution of marital property.

338. *See supra* note 28.

339. *See supra* note 310 and accompanying text. A further point of interest in this context is that in Loeb v. Loeb, 72 N.C. App. 205, 324 S.E.2d 33, *cert. denied*, 313 N.C. 508, 329 S.E.2d 393 (1985), the court considered the wife's vested remainder as part of her separate property. It emphasized, however, that "the non-speculative quality of the wife's rights to the trust fund distinguishes this from the vast majority of cases." *Id.* at 216, 324 S.E.2d at 41. In White v. White, 312 N.C 770, 324 S.E.2d 829 (1985), on the other hand, the supreme court seemed to consider, and at least point out, that the husband "has prospects of inheriting a substantial estate." *Id.* at 772, 324 S.E.2d at 830. It would appear that the analysis of the court of appeals is more sound and that the possibility of inheritance, which might well never occur, is not an appropriate nonstatutory factor for consideration under this section. *See, e.g., In re* Marriage of Stephenson, 121 Ill. App. 3d 698, 460 N.E.2d 1 (1983).

340. The court of appeals has not given a literal interpretation to the statutory directive that the income, property, and liabilities of a party "at the time the division of property is to become effective" be considered as a distributive factor. *See* N.C. GEN. STAT. § 50-20(c)(1) (Supp. 1985); *see also* Andrews v. Andrews, 79 N.C. App. 228, 234, 338 S.E.2d 809, 813-14 (1986) (1983 financial statements held to be sufficiently current as of 1984 hearing); Patton v. Patton, 78 N.C. App. 247, 253, 337 S.E.2d 607, 611 (1985) (income on *precise* date of hearing not required, relying on the well-established rule in alimony cases), *rev'd on other grounds*, No. 50A86 (N.C. Oct. 7, 1986). In Bradley v. Bradley, 78 N.C. App. 150, 152-53, 336 S.E.2d 658, 659-60 (1986), the court of appeals also held that "income" does not include public assistance payments such as food stamps and AFDC. It relied on the tax code and on the "ordinary meaning" assigned to income in reaching this result. *Id.*

The only questionable result reached thus far in this context came in Phillips v. Phillips, 73 N.C. App. 68, 75, 326 S.E.2d 57, 62 (1985), in which the court of appeals apparently held that the trial court had properly considered the present employment of wife's new husband as a statutory

party. And although future earning capacity, or lack thereof, is not a specific statutory factor, it is, as courts have begun to realize, equally significant and deserving of consideration.[341] This is a critical point: future earning capacities are especially likely to be a direct reflection of "marital economy" choices made by the spousal partnership during the marriage.

The second grouping of factors, which includes factors (5) through (8) and (11a), allows courts to consider spousal contributions that have had a more direct effect on the marital economy.[342] In particular, factors (5) (nonvested pension, retirement or other deferred compensation rights), and (7) (development of the career potential of the other spouse) appear designed to enable courts to compensate a spouse for his or her contributions to assets that are nonetheless the separate property of the other spouse. It is especially important, as courts have recognized, that factor (7) be considered when one spouse has, with the aid of the other, earned a professional degree.[343] Factors (6) and (8) appear to have a similar remedial purpose; the adoption of the source of funds approach with acquisition of marital assets, however, means that most of the considerations spelled out in these factors will have already been taken into account in the classification stage.[344]

Factor (11a), the most recent addition to this section of the statute, permits consideration of spousal behavior that affects the value directly, either positively or negatively, of marital property between the date of separation and the date of distribution.[345] Under *Smith v. Smith*,[346] moreover, spousal conduct that has an adverse impact on the marital economy can be considered without reference

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factor. It is difficult to construct a rationale under which such a factor could be encompassed within the "marital economy" theory of *Smith*.

341. *See, e.g.*, Loeb v. Loeb, 72 N.C. App. 205, 216, 324 S.E.2d 33, 41, *cert. denied*, 313 N.C. 508, 329 S.E.2d 393 (1985) (court observed that although the wife's current income was only $7,000 per year, she was seeking full-time employment as a CPA); *see also* Andrews v. Andrews, 79 N.C. App. 228, 231, 338 S.E.2d 809, 811 (1986) (defendant's greater earning capacity a factor, along with plaintiff's role as homemaker and custodian of children, in supporting an unequal division in favor of plaintiff); Appelbe v. Appelbe, 76 N.C. App. 391, 393, 333 S.E.2d 312, 313 (1985) (wife's ability to work impaired by chronic ill health).

342. *See supra* note 321 (listing the statutory factors).

343. The mere existence of such separate property is, as has been noted previously, a factor that must be considered even with equal divisions. *See* Dorton v. Dorton, 77 N.C. App. 667, 670, 336 S.E.2d 415, 418 (1985); Poore v. Poore, 75 N.C. App. 414, 423, 331 S.E.2d 266, 272 (1985). That one spouse supported, or otherwise aided, the professional spouse in obtaining such a license or degree is thus an additional factor favoring an unequal division in favor of the nonprofessional spouse. In the not uncommon situation in which divorce occurs shortly after the degree is received, and before substantial marital assets have been accumulated, this factor alone should justify a vastly disproportionate division of marital assets.

In cases that the original version of the Act governed, under which all pension and retirement benefits were deemed separate property, courts were similarly zealous in requiring that factor (5) be taken into account. *See, e.g.*, Dewey v. Dewey, 77 N.C. App. 787, 791, 336 S.E.2d 451, 454 (1985); Poore v. Poore, 75 N.C. App. 414, 423, 331 S.E.2d 266, 272-73 (1985). This factor should, moreover, continue to be given considerable weight, particularly in those still common instances wherein pension or retirement benefits require a number of years in service before vesting.

344. *See* Cable v. Cable, 76 N.C. App. 134, 331 S.E.2d 765 (1985).

345. It should be noted that this is the only section of the statute that allows "credit" to a spouse whose efforts after separation have been responsible for increases in value or preservation of marital property. The result is sensible because such efforts no longer belong to the marital community. This result should, moreover, be contrasted with that in Dorton v. Dorton, 77 N.C. App. 667, 336

to the "after separation" limitation.[347] In combination, factor (11a) and *Smith* would appear to constitute an especially powerful remedy for, as well as deterrent to, spousal efforts to convert, devalue, or waste the marital estate. Particularly in view of the limited effectiveness of injunctive relief and discovery sanctions, moreover, courts should not hesitate to assign considerable distributive effect to such behavior.[348]

The remaining factors—(9), (10), and (11)—all focus primarily on the nature and effect of distribution of a particular asset.[349] Tax consequences are, of course, also a relevant consideration with determination of a party's income or liabilities under factor (1). Given the drastic changes in the tax consequences of property divisions caused by the abolition of the *Davis* rule, however, the need to consider the tax consequences as a distributional factor will undoubtedly decrease.[350] In particular, transfers of property made "incident to divorce" will no longer result in any realization of gain.[351] Moreover, factor (11) has, quite correctly, been construed to require consideration only of those tax consequences that will *actually* result from any distribution of property ordered by a court.[352] Thus, in North Carolina, as in most other states, potential tax consequences, such as any gain that might be realized if an asset were sold in the future, are inappropriate for consideration as a distributional factor.[353]

Factors (9) and (10), on the other hand, create potentially more troublesome issues. Although the liquid or nonliquid character of an asset or the difficulty of valuation could well be appropriately considered in determining what particular assets will be distributed to whom,[354] it is extremely doubtful that the particular characteristics of an asset should play any real role in determining spousal distributive shares in such property.[355] This is clearly the rule in the

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S.E.2d 415 (1985), in which the husband was apparently allowed a "credit" for marital efforts. *Id.* at 679, 336 S.E.2d at 423. For further discussion of *Dorton*, see *supra* note 334.

It is also interesting to note that this factor clearly indicates that values of property at the *date of distribution* may be taken into consideration. *See supra* text accompanying notes 241-43.

346. 314 N.C. 80, 331 S.E.2d 682 (1985).

347. *Id.* at 88, 331 S.E.2d at 687; *see supra* text accompanying note 329.

348. *See supra* notes 79-80 (discussing the limited effectiveness of injunctive relief and discovery sanctions).

349. *See supra* note 321 (listing the statutory factors).

350. Under United States v. Davis, 370 U.S. 65 (1962), the transfer by one spouse to the other of appreciated property pursuant to divorce resulted in taxable gain to the transferor. The *Davis* rule was nullified by I.R.C. § 1041(a) which provides that "[n]o gain or loss shall be recognized on a transfer of property from an individual" to a spouse or an ex-spouse if such transfer occurs within one year of the divorce or is "related to the cessation of the marriage." I.R.C. § 1041(c) (1984). For further discussion of the Tax Reform Act, which also made radical changes in alimony law, see Sander & Gutman, *Tax Aspects of Divorce and Separation: A Detailed Analysis*, 11 FAM. L. RPTR. 135 (1986) (updated by Wicker).

351. *See supra* note 350. Thus, all transfers of property to an ex-spouse will, if related to divorce, be tax free.

352. *See* Weaver v. Weaver, 72 N.C. App. 409, 416, 324 S.E.2d 915, 920 (1985).

353. *See In re* Marriage of Key, 67 Or. App. 306, 677 P.2d 717 (1984).

354. Compare this with the discussion of factor (4) and the need of the custodial parent to own or occupy the marital home. *See supra* note 337. Andrews v. Andrews, 79 N.C. App. 228, 236, 338 S.E.2d 809, 814 (1986), also suggested that it would be appropriate to distribute particular items of property to a spouse for whom such items held special sentimental value.

355. When, for example, the obstructionist behavior of one spouse helped to create the valuation

majority of states that have addressed the issue.[356]

Such a result is strongly suggested elsewhere in the statute. In the first instance, the language of factor (10), that a court should consider "the economic desirability of retaining such asset or interest . . . free from any claim . . . by the other party,"[357] would appear to focus on the advantages of in kind distributions of some assets. More significantly, subsection (c), which creates the authority for distributive awards when a court determines "that an equitable distribution of all or portions of the marital property in kind would be impracticable,"[358] seems to be designed specifically to deal with such problems in such a fashion that the distributive shares of each spouse are *not* affected by the particular characteristics of an asset. Clearly, a contrary interpretation of these provisions would be a fundamental violation of the repayment of contribution rationale of the statute as a whole, and of the marital economy theory of the factors themselves.

VII. CONCLUSION

Substantively, procedurally, and analytically, passage of equitable distribution has created changes of unparalleled dimensions in the domestic law of North Carolina within the previous five years. The process of adjustment to this new system has not been easy. It has, nonetheless, been remarkably successful, particularly in view of the fact the statute itself is often confusing, vague, and even internally inconsistent. Guided by the undeniably strong remedial and fairness purposes of the Act, however, courts have made significant progress towards the implementation of meaningful partnership principles in the divorce settlement process.

Even an optimal equitable distribution system is not, however, a panacea. Divorce distributive principles cannot, for example, provide a full solution for the disparities in the post-divorce standards of living of most husbands and wives. Nor can they fully cushion the often severe economic impact of divorce on the lives of children. It must also be emphasized that the North Carolina statute is far from optimal. The continued exclusion of nonvested pension and retirement benefits from the definition of marital property, for example, remains a serious classification problem. The lack of effective statutory remedies for fraudulent or obstructionist spousal misconduct in the discovery and valuation stage creates very real opportunities for unequal spousal resources to result in inequitable distributive awards.

Nevertheless, the statute does provide the framework for the distribution of marital assets in a fashion that reflects the partnership assumptions of spouses in ongoing marriages and that legitimizes the long-ignored contributions, and often sacrifices, of homemaker spouses. This framework, symbolized above all by the

difficulties in the first instance, use of this factor in this manner could, in effect, reward the misconduct of such spouse.

356. *See, e.g.*, Bowen v. Bowen, 96 N.J. 36, 473 A.2d 73 (1984).

357. N.C. GEN. STAT. § 50-20(c)(10) (Supp. 1985).

358. *Id.* § 50-20(e) (1984).

equal division presumption, has been carefully and thoughtfully developed by the courts. The adoption of the source of funds approach, the elimination of marital fault as a distributive factor, and the flexible and fair interpretations given to various statutory terms are all logical and equitable extensions of the partnership principles embodied in the statute.

It is hardly surprising, however, that some problems have developed, and many issues remain unanswered in all three stages of equitable distribution proceedings. The failure of the appellate courts to distinguish clearly between use of the source of funds approach to determine ownership proportions of dual property and use of the active/passive distinction to apportion increases in value of separate property has created considerable difficulties. The restriction of the *McLeod v. McLeod*[359] gift presumption to contributions to the entireties estate is unnecessary and unfortunate. The courts need to continue to develop meaningful standards of review for valuation purposes for all complex business and corporate as well as professional enterprises. The courts should closely circumscribe the potential "wild card" effect of factor (12) by application of the supreme court's marital economy rationale in *Smith v. Smith*[360] to any prospective nonstatutory distributive factor.

The threat that some of these problems pose to the underlying policies and purposes of the statute is quite real, especially in view of the fact the process of adjustment to and development of the Act is far from complete. Problems that have arisen thus far should not, however, detract from the genuinely notable progress that has been made towards the development of truly equitable distributive results. Above all, it is clear that the foundation for the continued development and implementation of meaningful partnership principles has been well laid.

359. 74 N.C. App. 144, 324 S.E.2d 110, *cert. denied*, 314 N.C. 331, 333 S.E.2d 488 (1985).
360. 314 N.C. 80, 331 S.E.2d 682 (1985).