

**Bringing Consistency to the Financial Arrangements at Divorce**

*Kentucky Law Journal*, 87(1), 1998-9, 51-93.

by

Allen M. Parkman\*  
Regents Professor of Management  
Anderson Schools of Management  
University of New Mexico  
Albuquerque, NM 87131

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\* Regents' Professor of Management, University of New Mexico. B.A., Brown University, 1962; Ph.D.(Economics), University of California, Los Angeles, 1973; J.D., University of New Mexico, 1979.

## I. Introduction

While wedding vows have traditionally included the declaration that spouses are committing themselves to a union that will last until one of them dies, that has become less common as many marriages now end in divorce.<sup>1</sup> As a consequence, the financial arrangements at the end of a marriage are as likely to occur in a divorce court as a probate court. Unfortunately, the financial arrangements at divorce lack a consistent framework as they have developed in an ad hoc manner. Statutes establishing the standards for these financial arrangements, which potentially consist of child support, alimony/spousal support and a property division, have existed for a long time.<sup>2</sup> However, for most of American history these statutes were ignored. Until recently, the grounds for divorce were based on fault creating pressure for spouses, especially those with substantial assets, to negotiate the dissolution of their marriage including their own financial arrangements. Under the fault grounds for divorce it was very difficult to win a contested divorce,<sup>3</sup> so negotiated settlements in which the parties fabricated the necessary testimony to establish the fault grounds were a common practice.<sup>4</sup> A spouse who initially opposed a divorce sometimes could be induced to become the plaintiff in a divorce action based on an attractive financial and custodial package along with the realization that the other spouse no longer wanted to continue the marriage. In constructing this divorce package, the spouses usually

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<sup>1</sup> The divorce rate rose from 8 per thousand married women in 1920 to 22.6 per thousand married women in 1980 before declining to 20.9 in 1990. BUREAU OF THE CENSUS, HISTORICAL STATISTICS OF THE UNITED STATES: COLONIAL TIMES TO 1970 (1975) 64 and BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES, 1995 (1995) 102.

<sup>2</sup> Because there is more consistency in child support, the primary emphasis in this article is on alimony/spousal support and property division.

<sup>3</sup> In some cases such as when the “guilty” spouse sought the divorce or when there was no technical ground, a contested divorce was impossible to obtain. Moreover, the courts tended to apply more stringent standards to proof in contested cases. Last, contested fault divorces were messy and most people preferred to avoid them if at all possible. HARRY D. KRAUSE, FAMILY LAW, 3<sup>RD</sup> ED. (1995) 350.

<sup>4</sup> While collusion could be a bar to a divorce, the courts tended to accept the most perfunctory allegations as a basis for a divorce. *Id.* at 352. Max Rheinstein also notes that collusive practices and migratory divorce had been common in the United States under fault divorce. See MAX RHEINSTEIN, MARRIAGE STABILITY, DIVORCE AND THE LAW (1972) 247 and *A Survey of Mental Cruelty as a Ground for Divorce*, 15 DEPAUL L. REV. 159 (1965).

could ignore the applicable statutes controlling the financial arrangements.<sup>5</sup> So, for example, in a community property state that provided each spouse with an equal share of marital property at divorce, the spouse who initially resisted the divorce could ask for--and expect--a much larger share of the couple's assets.

This situation changed subtly, but dramatically, with the introduction of no-fault divorce during the last thirty years, since in most states a divorce could be obtained unilaterally.<sup>6</sup> The need for concessions by a spouse wanting a divorce diminished. Consequently, the gains from negotiations were reduced so that the financial arrangements at divorce were more likely to conform to the statutory standards. Either the parties accepted those standards or the courts were asked to apply them.<sup>7</sup> Even when the couple negotiated, they were often limited to trading off more predictable property for less predictable spousal support within the overall range of outcomes expected under the law.

With this new emphasis on these statutory requirements, the inconsistency of the financial arrangements at divorce became more apparent. The primary criterion for alimony was "need," the meaning of which and why the ex-spouse should be responsible for meeting it was hopelessly confused.<sup>8</sup> While the criteria used in property divisions were usually viewed as more straightforward, numerous problems existed. Although a marriage was based on the voluntary union of two people who committed themselves to applying their skills and efforts toward their common welfare, the property acquired during the marriage often was not attributed to both spouses. In many states, while both spouses worked in their separate environments, property was attributed to the spouse, usually the husband, who had title to the property if there was a divorce.<sup>9</sup>

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<sup>5</sup> KRAUSE, *supra* note 3 at 352.

<sup>6</sup> As the states reacted to the perjury ridden fault divorces, they over reacted making divorce a unilateral decision and "marriage a form of employment at will, typically without a golden parachute." KRAUSE, *supra* note 3 at 396. In a few states, such as New York, mutual consent is required for a no-fault divorce. Consolidated Laws of New York Annotated; Domestic Relations Law, Section 170.

<sup>7</sup> Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L. J. 950 (1979).

<sup>8</sup> Ira M. Ellman, *The Theory of Alimony*, 77 CAL. L. REV. 1 (1989); HOMER H. CLARK, JR., *THE LAW OF DOMESTIC RELATIONSHIPS IN THE UNITED STATES*, 2<sup>ND</sup> ED (1988) 620, KRAUSE, *supra* note 3 at 404 and AMERICAN LAW INSTITUTE, *PRINCIPLES OF THE LAW OF FAMILY DISSOLUTION: ANALYSIS AND RECOMMENDATIONS, PROPOSED FINAL DRAFT, PART I* (February 14, 1997) 5 [hereinafter cited as ALI PRINCIPLES].

<sup>9</sup> KRAUSE, *supra* note 3 at 428.

Other less tangible assets, such as pensions, sometimes were attributed only to the person earning an income.<sup>10</sup> In addition, the courts were only willing to consider a limited range of items as property. They recognized tangible assets such as houses and automobiles and financial assets such as shares of common stock and bonds, while ignoring individuals' increasingly important, but intangible, assets such as their income earning capacities.<sup>11</sup> These inconsistencies continued even after a divorce. If the couple divorced and then one of them filed for bankruptcy, the bankruptcy code permitted the discharge of property settlement obligations, while continuing support obligations.<sup>12</sup> These inconsistencies were less obvious during the fault divorce era because most divorces involving substantial financial resources had been negotiated and, therefore, the statutes had not been subjected to close scrutiny.

With closer judicial scrutiny because of the courts' more active role in these financial arrangements, constructive changes have occurred. Problems associated with alimony, which in many states is now called spousal support, have been reduced by limiting the situations under which it is provided.<sup>13</sup> For example, the Uniform Marriage and Divorce Act permits it only when two conditions have been met: the ex-wife has too little property to meet her needs and she is unable to support herself or has custody of a child that makes employment unrealistic.<sup>14</sup> Still, a convincing reason why alimony should be awarded even in these limited cases is lacking.<sup>15</sup>

The American Law Institute's Principles of the Law of Family Dissolution (Principles) attempt to provide additional clarity about the role of alimony by proposing that it should be

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<sup>10</sup> See *id.* at 444 and Grace Ganz Blumberg, *Marital Property Treatment of Pensions, Disability Pay, Workers' Compensation, and Other Wage Substitutes: An Insurance, or Replacement, Analysis*, 33 UCLA L. REV. 1250 (1986).

<sup>11</sup> See Allen M. Parkman, *Human Capital as Property in Celebrity Divorces*, 29 FAM. L. Q. 141 (1995).

<sup>12</sup> See Michaela M. White, *Divorce After the Bankruptcy Reform Act of 1994: Can You Stay Warm After You Split the Blanket?*, 29 CREIGHTON L. REV. 617 (1996) and Allen M. Parkman, *The Dischargeability of Post-Divorce Financial Obligations Between Spouses: Insights From Bankruptcy in Business Situations*, 31 FAM. L. Q. 493 (1997).

<sup>13</sup> CLARK, *supra* note 8 at 619.

<sup>14</sup> Uniform Marriage and Divorce Act § 308(a), 9A UNIF.L.ANN 160 (1979).

<sup>15</sup> Still, less than 15 percent of divorced women are awarded alimony, and only slightly more than 10 percent of them actually receive it. U.S. Department of Commerce, Bureau of the Census, Current Population Reports, *Child Support and Alimony*, Table G and I (1987).

based on compensating a spouse rather than on need.<sup>16</sup> These payments would provide compensation for a loss in living standard, in earning capacity, from an investment in the other spouse's earning capacity and in their ability to recover their premarital living standard after the dissolution of a short marriage.<sup>17</sup> Under the Principles, compensatory spousal payments for a loss in living standard or in earning capacity, like alimony, generally end with remarriage or death<sup>18</sup> and can be modified.<sup>19</sup> Compensation is based on a sharing of the spouses' post-dissolution incomes, although the income transfer often has only a very limited link to the loss incurred.<sup>20</sup> Alternatively, compensation for investments in the other spouse's earning capacity and to assist them in recovering their premarital living standard after the dissolution of a short marriage is more directly related to the actual losses incurred. These losses cannot be modified and do not terminate with remarriage or death.<sup>21</sup>

Still, the Principles lack consistency because they do not provide a logical reason why ex-spouses' incomes should be shared just because they were married. Without a clearly defined reason, numerous injustices will occur. For example, a woman, who made numerous sacrifices before marriage to acquire important income earning skills such as a medical education, will be forced to share her income with a man who did not make similar sacrifices either before or during marriage. On the other hand, if a spouse limits a career to provide important services in the home and that loss is recognized at dissolution, it will not disappear even if the person remarries when the Principles would normally terminate compensation.

During the last few decades, the rules governing the division of property at divorce have also been improved. Real property acquired during marriage is now treated as marital property irrespective of the name on the title.<sup>22</sup> Recognizing that a marriage is a partnership, assets acquired by an income earning spouse such as pensions are attributed to both spouses and are shared at divorce.<sup>23</sup> Inconsistencies still exist because of the limited range of assets recognized as

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<sup>16</sup> ALI PRINCIPLES at 259, § 5.02.

<sup>17</sup> Id. at 271, § 5.03.

<sup>18</sup> Id. at 350, § 5.08.

<sup>19</sup> Id. at 357, § 5.09.

<sup>20</sup> Id. at 280, § 5.05, and id. at 317, § 5.06.

<sup>21</sup> Id. at 406, § 5.17.

<sup>22</sup> AMERICAN BAR ASSOCIATION, YOUR LEGAL GUIDE TO MARRIAGE AND OTHER RELATIONSHIPS (1989) 58.

<sup>23</sup> J. THOMAS OLDHAM, DIVORCE, SEPARATION AND THE DISTRIBUTION OF PROPERTY (1996) 7-60, § 7.10..

part of the property division. Intangible assets such as individuals' income earning capacities are handled in an ad hoc manner. The distinction between separate and marital property also continues to be blurred. For example, in marriages of a minimum duration, the Principles would recharacterize a portion of separate property as marital property.<sup>24</sup> The Bankruptcy Code has been amended to make it more difficult for ex-spouses to avoid the financial obligations incurred during a divorce through bankruptcy, but the distinction between the dischargeability of support and property division obligations continues.<sup>25</sup> In summary, numerous inconsistencies continue in the financial arrangements at divorce because of the ambiguous role of alimony, the lack of a clear understanding of what is property and how it should be valued, and the treatment of support and property division obligations after dissolution.

This article argues that consistency in the financial arrangements at divorce can be increased by recognizing that they should be based on "debts" incurred during marriage and these debts should not be dischargeable in bankruptcy. A debt is something that one entity is bound to pay to another.<sup>26</sup> In a business setting, it commonly occurs when a creditor does something for a debtor, such as lending money. In other words, the creditor is making a sacrifice for the debtor's benefit for which it expects compensation. Similar sacrifices, although not as formal and often without a monetary transfer, commonly occur in marriages, thereby, creating debts. These debts can be from the couple to either a spouse or a child or from one spouse to the other. For example, a couple can acquire marital property such as mutual fund shares by saving, which is the sacrifice of current consumption, that should be treated as a debt of the couple to the spouses as individuals if there is a divorce. Other acts create a debt between the spouses such as uncompensated educational support. Electing to become parents imposes a debt obligation on the parents to support their children during their minority. More important than the current distinction between child support, alimony and the property settlement is whether these debts will be eliminated by remarriage or not.

The next section discusses the importance of consistency in the financial arrangements at divorce. That is followed by a section that discusses why the current system of financial arrangements lacks consistency. Then a framework is presented for why treating the financial obligations that result from marriage as debts at divorce promotes consistency. Last, the debt framework will be applied to the normal situations calling for compensation at divorce.

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<sup>24</sup> ALI PRINCIPLES at 238, § 4.18.

<sup>25</sup> White, *supra* note 12.

<sup>26</sup> WEBSTER'S ENCYCLOPEDIA UNABRIDGED DICTIONARY OF THE ENGLISH LANGUAGE (1989) 373.

## II. The Importance of Consistency in the Financial Arrangements at Divorce

While the ALI Principles express a concern for “an equitable sharing of the losses from the dissolution of the family relationship”<sup>27</sup> in the financial arrangements at divorce, a subtler, but equally important, goal should be consistent outcomes that encourage decisions that increase social welfare. The current inconsistencies work to frustrate that goal. Social welfare is increased when choices are made for which the benefits exceed the costs and the preferred choices result in the largest net benefits.<sup>28</sup> Many of the decisions made by adults prior to and during marriage are influenced by the financial arrangements, if they divorce. For example, if a divorce can be obtained easily based on no-fault grounds, but spouses are not adequately compensated for the diminution in their earning capacity because they sacrificed a career to work at home during the marriage, we would expect spouses to be reluctant to work at home during marriage.<sup>29</sup> Generally, people expect to be rewarded for their sacrifices and the larger, more predictable, and consistent the rewards, then the more likely they are to incur the sacrifices.

Marriages often benefit from sacrifices by family members. At the onset, there is the sacrifice of the opportunity to marry someone else. Sacrifices continue during marriage as spouses become parents and as they accumulate property. In all these cases, the sacrifices are incurred willingly because they are associated with substantial benefits. So long as the perceived net benefits are positive, these choices increase social welfare.

By ignoring the inconsistent statutory financial arrangements, negotiated divorces in the past had the ability to increase social welfare. For most of American history, the consensus was that seldom would a divorce improve social welfare and, therefore, there were severe restrictions on it. This was motivated, in part, by one man rarely being capable of supporting two families. In the 20<sup>th</sup> Century, divorces became more common based on fault grounds.<sup>30</sup> Still, it was not likely that a spouse wanting a divorce could conveniently obtain evidence of fault such as adultery, desertion or cruelty. Adultery, for example, was only a ground for divorce if asserted by the

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<sup>27</sup> ALI PRINCIPLES at xiii.

<sup>28</sup> For an opposing viewpoint, see Jeffery L. Harrison, “Egoism, Altruism, and Market Illusions: The Limits of Law and Economics,” 33 UCLA L. R. 1309 (1986).

<sup>29</sup> LENORE J. WEITZMAN, *THE DIVORCE REVOLUTION*, (1985); H. Elizabeth Peters, *Marriage and Divorce: Informational Constraints and Private Contracting*, 76 AM. ECON. REV. 437 (1986), and Allen M. Parkman, *Unilateral Divorce and the Labor-Force Participation Rate of Married Women, Revisited*, 82 AM. ECON. REV. 671 (1992).

<sup>30</sup> Particularly noteworthy was the increased labor force participation of married women. CLARK, *supra* note 8 at 410.

innocent spouse, not the one committing the adultery.<sup>31</sup> Therefore, most spouses who wanted a divorce had to obtain the cooperation of their mate.

Central to that cooperation was a package of concessions. While statutes established the financial arrangements at divorce, in their negotiations the spouses could ignore those statutes if the prescribed outcomes were inferior to those that they could arrange for themselves. Initially, by getting married the spouses must have concluded that the marriage increased their welfare and, therefore, that of society. Hopefully, that state continued. However, sometimes a spouse decided that he or she would be happier divorced.<sup>32</sup> At that point, it was not clear whether social welfare would be improved by a divorce. That would only occur if the benefit to the initiator exceeded the costs to others, especially the other spouse and their children. Ignoring the underlying statutes, the spouses could investigate whether there was a set of transfers from one to the other that would leave them both better. This occurred in an environment in which both spouses knew that the optimism that existed at marriage was no longer realistic. So while spouses who initially did not want a divorce would have preferred that the marriage returned to a happier time, they knew that was not likely. Therefore, there may have been a bundle of periodic payments, child support and property that the reluctant spouses saw as preferable to the current marriage. Any cost imposed on the children was in part addressed by the parent anticipating custody. The spouse who anticipated having custody of any children had incentives to take the welfare of the children into account. If the divorce was expected to have a disastrous effect on the children relative to their welfare if the marriage continued, then the spouse who anticipates custody had some incentives to consider this as part of their costs from divorce.<sup>33</sup> Meanwhile, if the spouses

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<sup>31</sup> KRAUSE, *supra* note 3 at 350.

<sup>32</sup> When both spouses more or less simultaneously decide that they would be better off divorced, the divorce was highly likely to improve social welfare especially if there were no children. Although the process that leads spouses to prefer a divorce to their current marriage is complicated, Gary Becker provided some valuable insights. People marry because they anticipate that they are going to be better off married to a particular person than they are going to be in any other living situation. However, they make that decision about the future with limited information. Frequently, they acquire additional information after marriage that leads them to the conclusion that they would be better off dissolving their marriage. He notes that the rapid accumulation of new information about your spouse during the first few years of marriage causes the divorce rates to be highest during those early years with it declining after four or five years. See GARY S. BECKER, *A TREATISE ON THE FAMILY* 326 (1991).

<sup>33</sup> Most authors agree that the preferred living arrangement for children is with their parents. See SARA MCLANAHAN & GARY SANDEFUR, *GROWING UP WITH A SINGLE PARENT* (1994) 1. However, a divorce may be better for the children than the continuation of an unhappy and disruptive marriage. See JUDITH S. WALLERSTEIN & SANDRA BLAKELEE, *SECOND CHANCES* (1990).

who initiated a divorce saw it as more valuable than the concessions necessary to obtain the divorce, they would be better off. While in an ideal world, there would never be an unhappy marriage and certainly no divorces, given the state of actual marriages, most negotiated divorce during the fault divorce era tended to increase social welfare.

Alternatively, these negotiations failed and there was no divorce, if the net benefits were negative. The spouse who initially wanted the divorce may have been unwilling or unable to provide concessions that would induce the other spouse to participate in the divorce. For example, a woman who thought that she no longer loved her husband, considered divorce and then realized that because of her husband's continuing attraction to her, he would require concessions that would make divorce unattractive. While the net benefits from this marriage may be very small, the consensus of the couple is that they are better off married than divorce.<sup>34</sup> Some exceptions to this process obviously existed because spouses could desert their families or alternatively abuse their spouses to the point that they would be willing to participate in the divorce. Desertion and abuse were restricted to some extent during most of American history by communities feeling that they had the right to supervise their marriages.<sup>35</sup> Still, by the middle of the 20<sup>th</sup> Century most marriages were dissolved with consensual divorces in which the spouses were voluntary, although not enthusiastic, participants. Therefore, by ignoring the underlying statutes most divorces obtained during the fault divorce era increased social welfare.<sup>36</sup>

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<sup>34</sup> See Allen M. Parkman, *Reform of the Divorce Provisions of the Marriage Contract*, 8 BYU J. OF PUBLIC L. 91, 102 (1993).

<sup>35</sup> See HELENA M. WALL, *FIERCE COMMUNION: FAMILY AND COMMUNITY IN EARLY AMERICA* (1990) 53.

<sup>36</sup> This is especially true because there were transaction costs associated with divorce that probably resulted in the benefits to initiators having to be substantially larger than the costs to the other spouse and children before there could be a divorce. See generally R. H. Coase, *The Problem of Social Costs*, 3 J. L. & ECON. 1 (1960). These transaction costs occur because of public goods, values can be in heterogeneous units, and the legal costs of divorce can be significant. See Douglas W. Allen, *Comment, Marriage and Divorce*, 82 AM. ECON. REV. 679 (1992). A public good is something that can be provided to additional people at little or no cost and it is difficult to exclude these people. Children are a public good for a married couple as both parents can simultaneously enjoy the children, which is no longer possible with divorce. See Martin Zelder, *Inefficient Dissolutions as a Consequence of Public Goods: The Case of No-Fault Divorce*, 12 J. LEGAL STUDIES 503 (1993). So if the parents love their children, a divorce imposes a cost on the non-custodial parent for which there is no corresponding benefit for the custodial parent. Negotiations can also be frustrated because the resources available to the family may be in heterogeneous units. An agreement is more likely to occur with homogeneous units such as money. If the wife wants more assets than prescribed by law and the husband is willing to give them, then an agreement can be reached. Alternatively, an agreement becomes more difficult

The likelihood that a divorce would increase social welfare decreased with the introduction of no-fault divorce because of the reduction in the negotiating power of the spouse who wanted to continue the marriage and the corresponding increase in the relevance of statutory standards. Divorces were now possible even when the gain to the spouse wanting the divorce was less than the cost to the other family members. Since a divorce could now be obtained by a spouse without the consent of the other spouse, the financial arrangements at divorce were more likely to conform to the legal standards that were often illogical, inconsistent and generally limited.<sup>37</sup> Alimony continues to be highly arbitrary and even less common than in the past.<sup>38</sup> The property settlements in both community property and equitable distribution states tend toward an equal division of a limited range of marital assets.<sup>39</sup> Child support is determined by guidelines in all states based on parents' incomes.<sup>40</sup> The likelihood increased that the financial arrangement at divorce would not adequately compensate spouses who made sacrifices during marriage for their family's benefit.

While the financial arrangements at divorce can consist of child support, a property division and alimony, the primary focus here is on the later two.<sup>41</sup> The reasons for and the

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if the husband is offering assets, but the wife wants the prestige associated with the current marriage. Last, any costs associated with divorce such as legal fees reduce the funds available for transfers between the spouses.

<sup>37</sup> Twenty years ago, judges had unfettered discretion regarding all elements of the economic consequences of divorce. See J. Thomas Oldham, *ALI Principles of Family Dissolution: Some Comments*, 1997 ILL. L. REV. 801.

<sup>38</sup> Only 14.6 percent of divorced women are awarded alimony in the 1980s and even fewer actually received it. U. S. Dept. of Commerce, Bureau of the Census, Current Population Reports, CHILD SUPPORT AND ALIMONY, Tables G and I (1987). Limiting alimony appears to be the position taken in the Uniform Marriage and Divorce Act, which only permits alimony where the person claiming it meets limited conditions. UMDA § 308(a), 9A Unif.L. Ann 160 (1979).

<sup>39</sup> See Blumberg, *supra* note 10.

<sup>40</sup> The couple could still negotiate, but the transaction costs that worked to keep the marriage together now worked to make divorce more likely. This is especially true because of heterogeneous units. The spouse wanting to maintain the marriage may be offering more of something that has little value to the spouse seeking the divorce.

<sup>41</sup> This discussion is based on the continuation of no-fault as being the primary ground for divorce. Because the courts are incapable of determining many of the costs of divorce, mutual consent may be a better ground for divorce from mature marriages. See Parkman, *Reform*, *supra*

computation of child support do not have the same problems as occur with the property division and alimony. The logic behind child support is fairly straightforward as society imposes certain responsibilities on people when they become parents. The most fundamental of those obligations is to support their children. During marriage, society does not have to assume a major role in that process. However, with the dissolution of the marriage the state has to assure that the financial needs of the child will be met. Because of problems with parents, usually fathers, fulfilling their obligations, Congress passed legislation, including the Family Support Act of 1988. States are required to create guidelines for child support awards, which are updated on a regular basis, and to automatically withhold support obligations from the paychecks of nonresident parents, if necessary.<sup>42</sup> As states have developed their child support guidelines, the dominant model that they have used in one based on income sharing by the parents.<sup>43</sup> The computation of child support guidelines in most states has been based on academic research.<sup>44</sup> A cost of the custodial parents that is not contained in these child support guidelines is any income that they sacrifice due to their responsibilities.<sup>45</sup> The Uniform Marriage and Divorce Act seems to contemplate that an award of child support might include a sum for the support of the child's custodial parent, but that is not a pattern contained in the states' child support guidelines.<sup>46</sup>

Actual property divisions and alimony do not have the consistency noted for child support. While statutes control the financial value of total awards, the spouses can negotiate allocation of

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note 34.

<sup>42</sup> See Allen M. Parkman, *The Government's Role in the Support of Children*, 11 *BYU J. OF PUB. LAW* 55 (1997).

<sup>43</sup> Robert G. Williams, *Implementation of the Child Support Provisions of the Family Support Act: Child Support Guidelines, Updating of Awards, and Routine Income Withholding*, in IRWIN GARFINKEL, SARA S. MCLANAHAN, AND PHILIP K. ROBINS, EDITORS, *CHILD SUPPORT AND CHILD WELL-BEING*, (1994), 93.

<sup>44</sup> Many states use the data from THOMAS ESPENSHADE, *INVESTING IN CHILDREN* (1984). The basic child support obligation consists of total child support excluding health insurance, work-related child care costs and extraordinary medical expenses.

<sup>45</sup> The Principles defers this issue to the chapter on child support. *ALI PRINCIPLES* at xl.

<sup>46</sup> The Uniform Marriage and Divorce Act § 308(b)(1), 9A UNIF.L.ANN 160 (1979) includes as a factor in awarding alimony any provision for support of a child which includes a sum for the custodian. However, most guidelines consider the direct costs of raising a child and then divide that cost based on the parents' incomes and the custodial arrangements. Williams, *supra* note 43 at 97.

the award between the property settlement and alimony as divorce settlements often are driven by their treatment after divorce rather than by legal standards. First, alimony is generally modifiable and a property division is not. Second, alimony usually ends if the recipient remarries, but that does not affect a property division. Third, alimony is usually enforceable by contempt, while in some states, the award of property is not.<sup>47</sup> Fourth, alimony, in contrast to a property division, cannot be discharged in bankruptcy. Last, alimony payments which comply with the statutory definition of alimony are taxable to the payee and deductible by the payer regardless of whether the purpose of the payments is support or the transfer of property between. Meanwhile, a transfer of property to a former spouse under a divorce decree is not a taxable event. Therefore, while the basic idea behind a property settlement is to return the parties' separate property and to divide the property acquired during the marriage and alimony is to serve other purposes such as to provide for the basic financial needs of a spouse, a particular couple's alimony and property division are often based on pragmatic considerations.

### **III. Inconsistencies in the Property Divisions and Alimony**

These pragmatic considerations just add to the confusion about why there are property divisions and alimony and how the amounts allocated to each spouse should be determined. In this section, the particular problems that result in inconsistencies in property divisions and alimony are addressed.

#### *A. Property Divisions*

Inconsistencies occur in property divisions because of the lack of a clear understanding of what is property and how it is affected by marriage. This is especially important because the Uniform Marriage and Divorce Act places the primary emphasis at divorce on the property division.<sup>48</sup> Traditionally, the purpose of the property division was to give to each spouse that property that he or she equitably owned, recognizing that in marriage the title to property often does not correspond to the rights of ownership.<sup>49</sup> This apparently straightforward process has been applied in an inconsistent manner. First, there are problems with the identification of the assets that should be considered in the property division. Second, inconsistencies exist in the

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<sup>47</sup> CLARK, *supra* note 8 at 592.

<sup>48</sup> The Uniform Marriage and Divorce Act § 308(a), 9A Unif.L. Ann 160 (1979) limits alimony to two situations. The person receiving alimony must show that she does not have sufficient property to provide for her reasonable needs, and that she is unable to support herself through appropriate employment or has custody of a child whose circumstances make it appropriate that she not seek a job outside the home.

<sup>49</sup> CLARK, *supra* note 8 at 593.

consideration of what is separate, in contrast to marital, property. Last, in many states the criteria used to allocate the items identified as property is so broad that virtually any outcome is legally possible.<sup>50</sup>

*i. What is Property?*

While a common concern at divorce is the property division, the statutes do not clearly define property. The equitable distribution statutes in the vast majority of jurisdictions define "marital property," but usually ignore the more basic definition of "property."<sup>51</sup> When the Principles consider the division of property upon the dissolution of marriage, it defines marital and separate property, but not "property" itself.<sup>52</sup> Furthermore, it states that it would have to define it,

“...if the term was meant to have a special meaning different from its meaning in other areas of the law, but no such special definition is necessary or desirable. The most frequent occasion for debate over the definition involves the law’s treatment of earning capacity and goodwill, but the characterization of these assets involves policy choices whose analysis is not aided by appeal to a general definition of property. The definition of marital property must follow from the policy choice; the policy choice is not determined by the definition.”<sup>53</sup>

Nothing could be further from the truth. When people were making their own financial arrangements at divorce, a clear definition of property was not essential or for that matter very important. However, that is no longer the case. There are numerous reasons why a clear understanding of what is property and how it is affected by marriage is important. It is not an acceptable conclusion that the law’s treatment of earning capacity and goodwill, for example, should be based on policy choices. If something is an asset and, therefore, property, it should be recognized as such with the normal standards for its identification and valuation. Public choices may then determine whether there are reasons for modifying the general rules for the allocation of property at divorce. Much of the confusion about how earning capacity and professional goodwill, for example, should be treated at divorce is due to the lack of a clear definition and understanding of property, something that can be remedied easily using the language of the financial and economic analysts who usually identify and value property.

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<sup>50</sup> Id. at 593

<sup>51</sup> See Da Silva, *Property Subject to Equitable Distribution*, in John P. McCahey & Barbara E. Adelman, *VALUATION & DISTRIBUTION OF MARITAL PROPERTY* 18-4 (Bender ed. 1984).

<sup>52</sup> The ALI PRINCIPLES at 90.

<sup>53</sup> Id.

Most fundamentally, the legal term “property” describes items that are “assets” in the financial and economic literature.<sup>54</sup> Rather than relying on property just being another word for an asset, the courts have classified items as property on an ad hoc, and often inconsistent, basis that includes a limited array of items.<sup>55</sup> Over time the sources of individuals' wealth--their property--have expanded from primarily things that are tangible such as stock certificates, cars and houses to intangible items such as the individuals' income earning capacities, pensions, and stock options. The courts have only slowly and inconsistently adapted to this new environment. Because many divorces with substantial property under fault divorce were negotiated with the parties reaching their own financial arrangements, there seldom was litigation that could have clarified the definition of property.

Divorce courts often resist the expansion of property to include intangible rights by requiring that something have value in exchange before it can be considered property.<sup>56</sup> Some courts hold that the owner must be able to sell it or pledge it for it to be property.<sup>57</sup> In addition, some courts have concluded that items that are property cannot be contingent in any way limiting spouses' rights in their spouse's future earnings or pension. Some states have expanded the concept of property to include some intangible items such as increased earning capacity and pensions.<sup>58</sup> In these states, the contingency of a right may not eliminate it from being property, but just limit its value. Because the courts have been uncomfortable radically changing the definition of property, the change has been made by statute.<sup>59</sup> So in West Virginia, for example,

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<sup>54</sup> An asset is property that has value as measured by its ability to generate future cash. ALAN C. SHAPIRO, MODERN CORPORATE FINANCE (1989) G-2. A standard formula for the value of an asset (V) with a permanent annual payment (\$N) when the relevant interest rate is  $i$  is  $V = \$N/i$ . See PAUL SAMUELSON & WILLIAM NORDHAUS, MICROECONOMICS, 15TH ED. (1995) 248. An asset that will generate annual payments of \$100 forever is worth \$1,000 if the relevant rate of interest is 10%. An asset exists and has value even though it cannot be sold such as individual's income earning capacity.

<sup>55</sup> Problems are often created when the courts address concepts from other fields, but rely on their own expertise to define and evaluate the concepts. See Allen M. Parkman, *The Multiplier in English Fatal Accident Cases: What Happens When Judges Teach Judges Economics*, 5 INT. REV. OF L. & ECON. 187 (1985).

<sup>56</sup> OLDHAM, DIVORCE, *supra* note 23 at 5-4, § 5.02[2].

<sup>57</sup> *Id.*

<sup>58</sup> *Id.* at 5-6, § 5.02[3].

<sup>59</sup> *Id.*

"marital property" includes "every valuable right and interest, corporeal or incorporeal, tangible and intangible."<sup>60</sup>

The definition of property used in most jurisdictions differs substantially from the one used by economists and financial analysts. In economic analysis, an asset exists and has value if it produces a future stream of returns, no matter whether it is exchangeable or not. Exchangeability has become a less common characteristic of assets because of the increase in the wealth consisting of human capital, which describes the capitalized value of the increased stream of earnings that will flow to an individual who has been the recipient of investments in skills or knowledge.<sup>61</sup> In other words, human capital is an asset owned by an individual. An asset exists and has value not because it can be exchanged for money, but because it will provide a stream of future returns. This difference can be illustrated by considering a share of common stock that has traditionally been recognized as property and a medical education that seldom has been treated similarly.<sup>62</sup> Although a share of common stock can be exchanged, no rational investor would pay a positive price for the common stock of a corporation that was never expected to earn any profits or pay any dividends. Meanwhile, medical school can be an attractive investment resulting in a valuable asset--human capital--although the doctor cannot sell herself or the degree.<sup>63</sup> An asset has value because of its future returns--both financial and psychic--not because of its exchangeability.

Our wealth or property consists of the assets that provide us with future returns. That property can consist of a house providing services that could be converted into a rental value, stocks and bonds that will provide dividends and interest, and the income stream that we can expect from the compensation for our services in the future. In contrast to a house, a share of common stock or a bond, the stream of future income from human capital cannot be sold. Conceptually, however, they are all assets or property.

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<sup>60</sup> W. Va. Code Ann. § 48-2-1.

<sup>61</sup> The primary source for the development of human capital is GARY BECKER, *HUMAN CAPITAL*, 3D ED. (1993). Numerous studies demonstrate the importance of human capital in explaining earnings. For example, see Michael P. Keane and Kenneth I. Wolpin, *The Career Decisions of Young Men*, 105 J. OF POL. ECON. 473 (1997).

<sup>62</sup> KRAUSE, *supra* note 3 at 453.

<sup>63</sup> The doctor can sell his or her services.

*ii. Separate and Marital Property*

Even with a broader recognition of property, there is still the question of whether the property should be treated as separate or marital.<sup>64</sup> As the courts have expanded the definition of property, the analysis of separate versus marital has been flawed.<sup>65</sup> The primary factor for determining how property should be treated is when it was acquired and the source of its funding. While property's value is based on its future returns, its acquisition is based on investments.<sup>66</sup> Investments in physical and financial assets and, therefore, their acquisition can usually be traced to particular transactions.<sup>67</sup> A car purchased before marriage is usually separate property, while a house purchased during marriage will usually be marital property.<sup>68</sup> This process is much less straightforward with human capital. The investments that create human capital occur over a long period and take many different forms making the partition between separate and marital property more difficult. We all have the innate ability to earn an income based on our natural intelligence and strength. Additional investments in education and training assist us in increasing our income earning capacity. In other words, investments create human capital. Then the question is whether investments occurred before marriage resulting in separate property or after marriage resulting in marital property.

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<sup>64</sup> The Uniform Marital Property Act created in 1983, if enacted by the states, would effectively create a nationwide system of community property in which separate property would be returned to its owner and community property shared at divorce. Uniform Marital Property Act (UMPA) § 10(b), 9A UNIF. L. ANN. 35 (Supp. 1983).

<sup>65</sup> Because of the lack of a clear understanding property, clear injustices often occur in property divisions under current legal standards. One reaction has been to convert separate property to marital property over the course of a marriage. See ALI PRINCIPLES, *supra* note 8, 8 at 238, § 4.18 and Stephen D. Sugarman, *Dividing Financial Interests on Divorce*, in STEPHEN D. SUGARMAN AND HERMA HILL KAY, *DIVORCE REFORM AT THE CROSSROADS* (1991) 159.

<sup>66</sup> Investment is the flow of expenditures devoted to projects producing goods which are not intended for immediate consumption. These investment projects may take the form of adding to both physical and human capital as well as inventories. See DAVID W. PEARCE, *THE MIT DICTIONARY OF MODERN ECONOMICS* 216 (3<sup>rd</sup> ed. 1986).

<sup>67</sup> The Principles recognize the importance of sacrifices as the basis for separate property becoming marital property. This occurs when either spouse devotes substantial time to the property's management or preservation. ALI PRINCIPLES at 112, § 4.05(1).

<sup>68</sup> Property acquired during marriage with separate property funds will generally continue to be separate property.

This type of analysis is totally lacking in the cases in which the courts have recognized human capital as property. Professional goodwill, which is the extension of business goodwill to professionals, was one of the first examples of the courts' recognition of human capital.<sup>69</sup> In addition to the standard method used for calculating business goodwill when a business is not being sold, the capitalization of enhanced earnings, the courts recognize a range of factors with no relevance to financial analysis such as "the length of time the professional has been practicing, his comparative success, his age and health, and any past profits of the practice. Attention should also be given to the physical and fixed resources of the practice."<sup>70</sup> Also, if professional goodwill existed, it was assumed--with no further analysis--that it was marital property even though important investments may have occurred before the marriage.<sup>71</sup> A given professional can have a high income for a variety of reasons that have nothing to do with their marriage. People who take larger risks and work harder expect to earn higher incomes. Also, people earn higher incomes because of investments made in them by their parents and society.

Professional goodwill has also been extended to celebrities.<sup>72</sup> Since methods of valuation are even more difficult there, the results have been even more inconsistent. While valuing celebrity goodwill, courts have accepted formulas with no foundation within the academic community such as one based on 25 percent of the celebrity's average gross earnings for three of the five years preceding the divorce being a good estimate of his celebrity goodwill.<sup>73</sup>

Even when the courts recognize a degree as marital property, which is evidence of human capital rather than human capital itself, the method accepted for valuation is flawed. In the O'Brien case,<sup>74</sup> the New York court awarded Mrs. O'Brien 40 percent of Dr. O'Brien's enhanced earning power based on the present value of the difference between the average income of a college graduate and that of a general surgeon over Dr. O'Brien's work life expectancy. It is inappropriate to base enhanced earnings for a surgeon on those of the average college graduate because the people who are admitted and eventually graduate from medical school are more

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<sup>69</sup> Allen M. Parkman, *The Treatment of Professional Goodwill in Divorce Proceedings*, 18 FAM. L. Q. 213 (1984) and Allen M. Parkman, *A Systematic Approach to Valuing the Goodwill of Professional Practices*, in RONALD L. BROWN, VALUING PROFESSIONAL PRACTICES AND LICENSE, (2nd ed. forthcoming).

<sup>70</sup> Hurley v. Hurley, 615 P.2d 256 (1980).

<sup>71</sup> Id.

<sup>72</sup> Piscopo v. Piscopo, 555 A.2d 1190 (N.J. Super. Ct. Ch. Div. 1988), *aff'd* 557 A.2d 1040 (N.J. Super. Ct. App. Div. 1989).

<sup>73</sup> 555 A.2d at 1041.

<sup>74</sup> 66 N.Y.2d 576, 489 N.E.2d 712, 498 N.Y.S.2d 743 (1985).

intelligent and ambitious than the average college graduate and, therefore, would have been expected to have a higher income than the average college graduate even if they had not gone to medical school. In addition, since there are no arms length transactions as normally exist in financial markets, the choice of a 40 percent equity interest is totally arbitrary.

The inconsistencies created by the law in this area can be illustrated by considering parental investments. The parents might invest in a portfolio of common stocks for their child. If the child marries, devotes very little time to managing the portfolio, does not commingle it with other marital assets and then divorces, in most jurisdictions the portfolio will be returned to her as separate property.<sup>75</sup> Alternatively, if the parents invest their time and money before marriage providing the child with a superior education and, therefore, a higher than average income after marriage, the result could be the recognition of professional goodwill as a marital property if there is a divorce and the award of alimony.

*iii. How Should Property be Allocated?*

Because of the limited items considered property and the lack of a clear understanding of what should be treated as marital in contrast to separate property, a straightforward approach that would return each parties' separate property and allocate the marital property equally would commonly result in patently unjust results. Therefore, the property division statutes in many states include a list of factors to be considered by the courts including the financial and non-financial contributions of both spouses to the marriage and the post divorce economic circumstances and needs of the spouses.<sup>76</sup> The recommended alternative section of the Uniform Marriage and Divorce Act for the disposition of property calls for the court to allocate all the property of the spouses, no matter how it was acquired, based on a substantial list of factors.<sup>77</sup> In making its apportionment, the court is directed to "consider the duration of the marriage, any prior marriage of either party, any antenuptial agreement of the parties, the age, health, station, occupation, amount and sources of income, vocational skills, employability, estate, liabilities, and needs of each of the parties, custodial provisions, whether the apportionment is in lieu of or in addition to maintenance, and the opportunity of each for future acquisition of capital assets and

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<sup>75</sup> See CLARK, *supra* note 8 at 595. The Principles, in contrast, would gradually convert some separate property into marital property in long duration marriages, in part because it argues that the spouses usually start treating it that way. See ALI PRINCIPLES at 240, § 4.18, comment a. Based on his personal experience, at least one commentator disagrees with this argument.

<sup>76</sup> CLARK, *supra* note 8 at 594.

<sup>77</sup> The Uniform Marriage and Divorce Act § 307, 9A UNIF.L.ANN. 160 (1979).

income.”<sup>78</sup> The court is also instructed to “consider the contribution or dissipation of each party in the acquisition, preservation, depreciation, or appreciation in value of the respective estates, and as the contribution of a spouse as a homemaker or to the family unit.”<sup>79</sup> The other alternative version of this section, which was included based on the concerns of the community property states, is also ambiguous. After assigning each spouse’s separate property to that spouse, the court is directed to allocate the marital property “. . . after considering all relevant factors including:

- (1) contribution of each spouse to acquisition of the marital property, including contribution of as spouse as homemaker;
- (2) value of the property set apart to each spouse;
- (3) duration of the marriage; and
- (4) economic circumstances of each spouse when the division of property is to be effective, including the desirability of awarding the family home or the right to live therein for a reasonable period to the spouse having custody of any children.”<sup>80</sup>

These factors permit the courts to make almost any allocation that they want to make. Spouses with the similar fact situations can reasonably expect contradictory decisions in different courts or in the same court at different times. Given this broad, ambiguous discretion, courts in both common law and community property states have tended to divide the items recognized as marital property equally.<sup>81</sup>

In summary, the courts have not developed a systematic understanding of what is property from the perspective of the experts who deal with that question. Even with the limited range of items considered property, the methods used for its allocation and evaluation are often arbitrary.

### *B. Alimony*

It has been a long time since the logic and purpose of alimony was clear. In the United States, the practice of granting alimony in conjunction with a divorce was adapted from English law. Prior to the 1857 reform of the English divorce laws, most divorces there were handled by the ecclesiastical courts, which only gave divorces that authorized the husband and wife to live apart, while otherwise continuing their marriage.<sup>82</sup> The alimony that was awarded by these courts

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<sup>78</sup> *Id.*

<sup>79</sup> *Id.*

<sup>80</sup> *Id.*

<sup>81</sup> AMERICAN BAR ASSOCIATION, *supra* note 22 at 58.

<sup>82</sup> In England prior to 1857, an absolute divorce could only be obtained through an act of Parliament and, therefore, was very uncommon. See CLARK, *supra* note 8 at 620.

merely continued the husband's duty to support the wife. This was especially important at that time, because the employment opportunities and remarriage prospects for women were severely restricted. In addition, a wife turned over control of her property to her husband when she married.

In contrast, absolute divorces were available in most of the United States from an early date. Therefore, while the use of alimony in England served the plain and intelligent purpose of providing support for wives living apart from their husbands, the rationale for awarding it in the United States for absolute divorces was much less clear.<sup>83</sup> As noted by Homer Clark in his treatise on family law,

“If we do not know what we are trying to accomplish by giving a spouse alimony, we will not easily be able to decide whether it should be granted in a particular case, or, if granted in what amount. The situation is not clarified by statutes which vary widely in listing the relevant facts to be considered, and by appellate decisions which likewise state or assume that alimony has many different functions. The idea that alimony is a substitute for the traditional duty of a husband to support his wife still has great currency in the cases but today alimony can be only partially explained on this ground”<sup>84</sup>

As a result, alimony is applied in a very haphazard and inconsistent manner at divorce.<sup>85</sup> It is granted in less than one-fifth of all divorces, and in less than half of those divorces terminating marriages of more than fifteen years.<sup>86</sup> Even when mothers are limited in their ability to work because of their having custody of minor children, alimony as distinguished from child support is made in less than one quarter of cases.<sup>87</sup> Recognizing the lack of a clear logic behind alimony, the Uniform Marriage and Divorce Act restricts the award of alimony to a spouse who has neither property nor income sufficient for her support, then list six factors to be considered in arriving at an equitable award.<sup>88</sup>

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<sup>83</sup> Id.

<sup>84</sup> Id at 641.

<sup>85</sup> See Ellman, *supra* note 8 and Mary E. O'Connell, *Alimony After No-Fault: A Practice in Search of a Theory*, 23 NEW ENGLAND L. REV. 437 (1988).

<sup>86</sup> WEITZMAN, *supra* note 29 at 169.

<sup>87</sup> Id. at 186.

<sup>88</sup> Section 308. [Maintenance.]

(a) In a proceeding for dissolution of marriage, legal separation, or maintenance following a decree of dissolution of the marriage by a court which lacked personal jurisdiction over the absent spouse, only if it finds that the spouse seeking the maintenance:

The attempt in the Principles to bring consistency to what has been called spousal support or alimony will not fulfill its promise.<sup>89</sup> Recognizing the lack of agreement regarding the purpose of alimony, it recommends a policy of compensatory spousal payments based on losses rather than to meet needs.<sup>90</sup> These payments are to cover “financial claims between spouses arising in the dissolution of their marriage, other than claims for a share in their property or for support of their children.”<sup>91</sup> Because of the lack of a clear understanding of property, the losses covered are not recognized as property claims, which they are in most cases. The ad hoc nature of these provisions is evidenced by some awards being fixed at dissolution, while others can be modified and terminated with remarriage or death. Compensation is provided for the loss of marital living standard,<sup>92</sup> for being the primary caretaker who incurs a loss in earning capacity,<sup>93</sup> for the loss of

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- (1) lacks sufficient property to provide for his reasonable needs; and
  - (2) is unable to support himself through appropriate employment or is the custodian of a child whose condition or circumstances make it appropriate that the custodian not be required to seek employment outside the home.
- (b) The maintenance order shall be in amounts and for periods of time the court deems just, without regard to marital misconduct, and after considering all relevant factors including;
- (1) the financial resources of the party seeking maintenance, including marital property apportioned to him, his ability to meet his needs independently, and the extent to which a provision for support of a child living with the party includes a sum for that party as custodian;
  - (2) the time necessary to acquire sufficient education or training to enable the party seeking maintenance to find appropriate employment;
  - (3) the standard of living established during the marriage;
  - (4) the duration of the marriage;
  - (5) the age and physical and emotional condition of the spouse seeking maintenance; and
  - (6) the ability of the spouse from whom maintenance is sought to meet his needs while meeting those of the spouse seeking maintenance. Uniform Marriage and Divorce Act § 308, 9A UNIF.L.ANN. 160 (1979).

<sup>89</sup> ALI PRINCIPLES.

<sup>90</sup> *Id.* at 259, § 5.02.

<sup>91</sup> *Id.* at 257, § 5.01(1).

<sup>92</sup> *Id.* at 280, § 5.05. Compensation, without any evidence of the type of sacrifice covered by § 5.06 has caused some commentators to call for the abolition of this section. See Oldham, ALI, *supra* note 37 at 816.

<sup>93</sup> *Id.* at 317, § 5.06.

earning capacity arising from the care of third parties,<sup>94</sup> for contributions to the other spouse's education or training,<sup>95</sup> and for the restoration of the premarital living standard after a short marriage.<sup>96</sup> Compensatory spousal payments for a loss in living standard or in earning capacity, like alimony, generally end with remarriage or death<sup>97</sup> and can be modified.<sup>98</sup> In these cases, this compensation is based on a sharing of the spouse's post dissolution incomes, which often has only a very limited link to the loss incurred.<sup>99</sup> Working at home during marriage is only a basis for compensation if the couple has children.<sup>100</sup> If a talented woman marries a man with lower earnings and they elect for her to work in the home even without children, thereby, limiting her career, she may receive no compensation if the marriage is dissolved even if she has to reenter the labor force at a much lower income level than she would have had without the disruption in her employment. Moreover, if the primary caretaker has a higher potential income after dissolution than the other spouse, she will receive no compensation for any reduction in her income due to her working in the home. Maintaining the ad hoc nature of the law in this area, the Principles note that it is contrary to existing law for the lower income spouse to compensate the higher income

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<sup>94</sup> Id at 380, § 5.12.

<sup>95</sup> Id at 383, § 5.15.

<sup>96</sup> Id at 394, § 5.16.

<sup>97</sup> Id. at 350, § 5.08.

<sup>98</sup> Id. at 357, § 5.09.

<sup>99</sup> Compensation based on the parties' disparate financial capacity is determined by applying a marriage duration factor to "the difference between the incomes the spouses are expected to have after dissolution," Id. at 272, § 5.05(3), while compensation for primary caretaker's residual loss in earning capacity is determined by applying a "child care durational factor to the difference between the incomes that spouses are expected to have after dissolution." Id. at 318, § 5.06(4). Another concern is based on most divorces being initiated by the lower income spouse with the result that the person who initiated the divorce is rewarded with a income transfer from the spouse who wanted the marriage to continue. See Sanford L. Braver, Marnie Whitley, & Christine Ng, *Who Divorced Whom? Methodological and Theoretical Issues*, 20 J. OF DIV. & REMARRIAGE 1 (1993). Still, a sharing of post dissolution income is popular among many academics. For example, see Jana Singer, *Divorce Reform and Gender Justice*, 67 N. C. L. REV. 1103 (1989), Sally F. Goldfarb, *Marital Partnership and the Case for Permanent Alimony*, 27 J. OF FAM. L. 351 (1988-9) and Cynthia Starnes, *Divorce and the Displaced Homemaker*, 60 U. CHI. L. REV. 67 (1993).

<sup>100</sup> Id. at 335, § 5.06, Reporter's Notes. Comment a.

spouse even though it is that spouse who incurred a sacrifice because of the marriage.<sup>101</sup> Sacrificing or limiting a career affects that spouse's human capital and, therefore, should be recognized in the property division.

Certain remedies accepted by the Principles, such as compensation for losses for investments in the other spouse's earning capacity and in their ability to recover their premarital living standard after the dissolution of a short marriage are more directly related to the actual loss incurred and they cannot be modified and do not terminate with remarriage or death.<sup>102</sup> In many ways, these provisions cover the effects of marriage on human capital that would be more systematically covered in the property division.

The attraction of this process is its predictability,<sup>103</sup> but the result is arbitrary outcomes and perverse incentives. In many cases, people are randomly rewarded for having been fortunately enough to have married someone who eventually has a high income. If the high income was an incentive for the marriage and the lower income spouse sacrificed the opportunity to have married someone equally successful, then that loss should be clearly stated. If the higher income was unexpected and, therefore, not the basis of the marriage, then to reward the lower income spouse may be appealing, but it should be recognized as capricious. The more telling criticism is the effect on incentives. Without a premarital agreement, individuals with the potential for a high income have incentives to avoid marriage, while those with a low potential income has incentives to pursue marriage for the wrong reasons. After dissolution, both spouses have incentives to limit their incomes because they are sharing it with each other under circumstances in which they would have made their own arrangements if the sharing was voluntary. The lower income spouse has incentives to emphasize the need for rehabilitation resulting in zero or negative income even when the rehabilitation is not productive. Meanwhile, the spouse with the higher income has incentives to avoid higher income opportunities. In addition, incentives to move on with one's life are also restricted as the payments can end if the lower income spouse remarries.

These examples provide an introduction to the next section of this article in which it is argued that the current distinction between property divisions and alimony and the Principles' proposed distinction between property and compensatory spousal payments lack consistency. Consistency and improved incentives can be created by recognizing that the financial arrangements at divorce should be based on the debts incurred during the marriage.

#### **IV. Debt as the Basis for Financial Obligations at Divorce**

The financial obligations at divorce should be based on debts incurred during marriage. People make choices due to their being married and some of these choices result in debts, which

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<sup>101</sup> Id. at 325, § 5.06, Comment d.

<sup>102</sup> Id. at 406, § 5.17.

<sup>103</sup> Id. at 326, § 5.06, Comment e.

are obligations of one person to pay or compensate another.<sup>104</sup> Of course, if the marriage ends due to a spouse's death, the recognition of these debts is usually not important.<sup>105</sup> The same cannot be said for divorce. Then one of the most certain issues is what is his and what is hers? Consistency would be improved by replacing the current system of property divisions and alimony with one based on debt, which would be an extended version of the current property divisions.

This can be illustrated using an economic perspective, which has become increasingly popular for analyzing marriage and the family.<sup>106</sup> While accepting love and sexual attraction as essential for family formation, this literature also analyzes the family as an institution consisting of individuals who respond to changing incentives based on costs and benefits. In economics, a cost is associated with a sacrifice, rather than just the narrow meaning of a money outlay. For example, marrying imposes a cost on the spouses because they have sacrificed the opportunity to have married someone else.

Spouses make sacrifices during marriage that benefit the other family members. While altruism can be a pertinent force in close relationships, economic analysis suggests that a strong incentive for making these sacrifices are the benefits that the spouses expect, often in the future, in return. The essence of marriage consists of reciprocal arrangements. While neither washing the family car by one spouse nor cooking dinner by the other will result in positive net benefits for that person, the combination of activities will result in positive net benefits for the couple. Neither activity is done in isolation, but is part of the reciprocal arrangements of marriage. One was done in anticipation of the other. The car wash and the meal are activities that are reasonably contemporary, so the spouses may not be concerned about whether the reciprocal actions will occur. However, the benefits may occur long after the costs were incurred, such as when educational support is provided by spouses, resulting in a debt of the beneficiaries to persons incurring the cost. These costs, which produce many of the gains from marriage and a family, are more likely to be incurred if there is a reasonable assurance that the people making the sacrifice will be compensated, in effect, creating creditor/debtor relationships. The debts incurred during marriage need to be clearly defined along with the determination of whether they are extinguished by remarriage.

If the likelihood increases that compensation will not be received for sacrifices, then spouses are discouraged from making welfare enhancing decisions for which the benefits exceed

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<sup>104</sup> STEVEN H. GIFIS, LAW DICTIONARY 53 (1975).

<sup>105</sup> The spouse who should be compensated for a debt is either dead or being compensated under probate law. If the compensation is inadequate, then that is an issue for probate law.

<sup>106</sup> Much of this work can be traced to Gary Becker, the University of Chicago Nobel Prize winning economist-sociologist. His work is summarized in GARY S. BECKER, A TREATISE ON THE FAMILY, ENLARGED EDITION (1991). Also see W. KEITH BRYANT, THE ECONOMIC ORGANIZATION OF THE HOUSEHOLD (1990) and ALESSANDRO CIGNO, ECONOMICS OF THE FAMILY (1991).

the costs.<sup>107</sup> Spouses often make sacrifices that may not be in their narrowly defined best interest, but are incurred because they are viewed as in the best interest of their marriage and their best interest in the long run. If these sacrifices are not made, the overall quality of the marriage is reduced. For example, a couple's children might benefit from one parent limiting a career to provide important child care services. The parents might, however, be reluctant to incur the potential cost of limiting a career, if they are not sure that they will be compensated financially and emotionally by the other spouse and the children.<sup>108</sup> This lack of compensation can be due to the financial and custodial arrangements, if there is a divorce, not recognizing systematically the costs that they have incurred.<sup>109</sup> In addition, even if these costs are recognized in a property division, they might be avoided if an ex-spouse files for bankruptcy. As a consequence, the parents focus on their careers to the detriment of their children.

Costs are incurred during marriage in a number of situations for which compensation using a debt perspective would be appropriate, if the marriage is dissolved. When people marry, they sacrifice the opportunity to marry someone else. The couple may choose to have children recognizing the future time, money and emotional costs that the children will require. The spouses may sacrifice current consumption to save, thereby, accumulating marital property. To accommodate their spouse and children, spouses may limit their career potentially reducing their future income. Last, spouses may sacrifice some of their earnings to finance the education of their spouse.

All of these sacrifices should be viewed as potentially creating debts, either to the other spouse or to their children, if the marriage is dissolved. These debts are discussed next.

#### A. *Alimony*

The rationale for alimony or spousal support would be more consistently related to the other financial arrangements at divorce if it was recognized that it should *only* be based on the sacrificed opportunity to have married someone else under circumstances that resulted in a debt. When the primary role available for adult women was as a housewife and mother, women's chief

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<sup>107</sup> Because no-fault divorce permits unilateral divorce often accompanied by limited financial compensation for women who have limited their careers to benefit their families, married women have been forced to take steps to protect themselves from the potential adverse effects of divorce. Since they are acting in their best interest rather than that of their families, this lack of protection for their investments often induces them to make inefficient decisions for their families because the benefits do not exceed the costs. See Allen M. Parkman, *Why Are Married Women Working So Hard?*, INT. REV. OF LAW & ECON., (forthcoming)

<sup>108</sup> *Id.*

<sup>109</sup> Parkman, *Unilateral Divorce*, *supra* note 29.

cost of divorce was the sacrificed opportunity to have married someone else.<sup>110</sup> This cost could be substantial because of women's limited opportunities for remarriage and employment. In 1900, only 3 percent of brides were divorced.<sup>111</sup> Employment opportunities also were restricted as only 20 percent of women were in the labor force and that percentage declining with age to less than 14 percent for women between 45 and 64 years old.<sup>112</sup> Alimony, therefore, served the purpose of compensating women for the costs associated with marrying a particular man. Still, it seldom maintained the same lifestyle as during marriage creating incentives for both spouses to consider marriage carefully. In effect, both spouses shared the cost of repaying the debt to the wife who incurred this sacrifice. The cost was shared because the husband paid it, but the wife could not anticipate an income similar to the one during marriage. Still, in the negotiated settlements that often occurred under the fault grounds for divorce, the legal criteria for alimony often were secondary to the practical outcomes that were driven by tax considerations and the bargaining positions of the spouses.

To the extent that alimony was awarded earlier in this century, it was reasonable to assume that the women--except for this marriage--would have married someone similar to the person that they married, so the cost of the divorce and the resulting debt was a lifestyle similar to the one enjoyed during the marriage. Since the debt was tied to the dissolution of a marriage, it was logical for the debt to be repaid with periodic payments that could be modified and would end with remarriage or death. This was probably more important when it was more likely that a woman's family was more involved in her marriage decision and she was more likely to marry within her social class.<sup>113</sup>

Gradually, alimony based on a lost lifestyle became less appropriate. As women became more independent, the likelihood increased that a marriage would occur across income classes. The assumption that a woman except for this marriage would have married someone with an income similar to her husband's became less likely. A divorce also had a smaller impact on women's income because of their increased employment opportunities. The labor force

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<sup>110</sup> Margaret F. Brinig and June Carbone, *The Reliance Interest in Marriage and Divorce*, 62 TULANE L. REV. 855 (1988).

<sup>111</sup> PAUL H. JACOBSON, *AMERICAN MARRIAGE AND DIVORCE* (1959). Also, see ANDREW J. CHERLIN, *MARRIAGE, DIVORCE, REMARRIAGE* 27 (1992).

<sup>112</sup> BUREAU OF THE CENSUS, *HISTORICAL STATISTICS*, supra note 1 at 132.

<sup>113</sup> In colonial America, parents influenced their children's marriages in significant ways, most importantly in the matter of consent. Minor were required to get it, while most adult children also sought it to preserve hopes for inheritance as well as to maintain filial affection. See WALL, supra note 35 at 49. Also, see EDWARD SHORTER, *THE MAKING OF THE MODERN FAMILY* (1975).

participation rate of married women increased from 32 percent in 1960 to 61 percent in 1994.<sup>114</sup> This trend is especially dramatic for mothers with children less than six years of age, whose labor force participation rate increased from 19 percent to 62 over the same period.<sup>115</sup> To the extent that marriage is a preferred state for women, the cost of divorce has increased because the likelihood of remarriage had fallen for divorced women. Among those women divorce during 1965-9, 73 percent had remarried within five years.<sup>116</sup> That percentage fell to less than 50 percent for those divorced during 1980-4. Therefore, the loss due to divorce is less a financial one than a psychological one.

Alimony, especially under the Principles, has become more an arbitrary reallocation of income than a basis for compensating spouses for their loss. Imposing the burden of this reallocation on the higher income spouse if a marriage is dissolved seems out of line with the shift to no-fault divorce grounds. Moreover, compensating someone for the lost opportunity to have married someone else presents the courts with a difficult, or impossible, task that might be better served by recognizing it as an exceptional case, thereby, encouraging the affected people to make their own arrangements using a premarital agreement. A more appropriate concern is compensation for spouses who incur a sacrifice by limiting a career that will be discussed below and for which periodic payments extinguished by remarriage or death is not appropriate. If the court were to determine that alimony is appropriate because the spouses recognized that one was making a major sacrifice by marrying, the resulting debt should be shared by the spouses with it terminating at remarriage or death. This is the only debt that should end with remarriage.

Current reforms are not an improvement over existing standards. A formula such as the one proposed by the Principles that transfers income from the higher to the lower income spouse after dissolution just because they were married is highly arbitrary. This transfer is independent of whether the lower income spouse made any sacrifices for the benefit of the marriage, which it covers under compensation for a primary caretaker's residual loss in earning capacity. The Principles state that this remedy is based on "compensation for loss" rather than "relief of need."<sup>117</sup> Imposing this loss on the higher income spouse is based on "the unfair allocation of the financial losses arising from the marital failure."<sup>118</sup> By shifting the rhetoric of alimony, now called

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<sup>114</sup> US BUREAU OF THE CENSUS, STATISTICAL ABSTRACT, *supra* note 1 at 405.

<sup>115</sup> *Id.* at 406.

<sup>116</sup> *Id.* at 104.

<sup>117</sup> ALI PRINCIPLES at 261.

<sup>118</sup> *Id.* When the income that used to be available to one household is divided between two household, both households have to be worse off. The only issue is which is worse. Numerous citations have been made to Lenore Weitzman's conclusion that divorced men were 42 percent better off after divorce and women and children were 73 percent worse off.

compensation payments, from “need” to “loss” does not make the illogical logical. Unless there is a debt, the payment is essentially a penalty.

A difference in incomes after divorce alone is not a rational basis for compensation between ex-spouses. People have different incomes for a variety of reasons many of which have nothing to do with their marriage. Some of the obvious factors are intelligence and diligence. Earnings are also affected by the attraction of occupations with riskier and less comfortable jobs paying more.<sup>119</sup> Finally, earnings vary because of workers’ characteristics such as race and sex.<sup>120</sup> Of particular relevance to marriage is the fact that women continue to earn less than men. In 1992, full time year round employed women made \$25,727 in contrast to the \$38,533 earned by similarly situated men.<sup>121</sup> Without evidence that a woman’s lower income is the result of sacrifices made for the benefit of the family, it is highly arbitrary to impose this cost on the higher income spouse. Except for sacrifices made for the benefit of the family, the reason for these wage differentials between men and women lie outside the family. Therefore, the solution has to occur there and that is occurring as the wage gap is decreasing as women have started to act more like men by entering similar occupations and maintaining a stronger attachment to the labor force.<sup>122</sup> Mandatory compensation from higher to lower income spouses just because they were married discourages higher income individuals from marrying, while creating disincentives after divorce for the spouses to get on with their lives.

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WEITZMAN, *supra* note 29 at 323. While Weitzman researched has been questioned by many authors, the most systematic attack has been in Richard R. Peterson, *A Reevaluation of the Economic Consequences of Divorce*, 61 AM. SOC. REV. 528 (1996); Lenore Weitzman, *The Economic Consequences of Divorce Are Still Unequal: Comment on Peterson*, 61 AM. SOC. REV. 537 (1996); Richard R. Peterson, *Statistical Errors, Faulty Conclusions, Misguided Policy: Reply to Weitzman*, 61 AM. SOC. REV. 539 (1996).

<sup>119</sup> RANDALL K. FILER, DANIEL S. HAMERMESH, & ALBERT E. REES, *THE ECONOMICS OF WORK AND PAY* 372 (1996).

<sup>120</sup> *Id.* at 525. Pay differentials among starting salaries for men and women disappear when mathematical skills are taken into account. Thomas Daymont & Paul Andrisani, *Job Preferences, College Major and the Gender Gap in Earnings*, 19 J. OF HUMAN RES. 408 (1984).

<sup>121</sup> BUREAU OF THE CENSUS, *CURRENT POPULATION REPORTS*, P-60, No. 184, Table 26.

<sup>122</sup> June O’Neill and Solomon Polachek, *Why The Gender Gap in Wages Narrowed in the 1980s*, 11 J. LABOR ECON. 205 (1993).

*B. Child Support*

While child support has not been a major focus of this article, it is consistent with the debt framework for the financial arrangements at divorce. Child support should be based on a debt of the parents to their children. The costs of children continue even if the marriage is dissolved as the children still need to be feed, clothed, and nurtured. Parents historically had children because they were a source of financial support, love and companionship. More recently, the financial incentives for parenthood essentially have been eliminated. Still, in return for the anticipated benefits of parenthood, society imposed a joint obligation on the parents to support their minor children. Child support guidelines determine how parents share those costs. However, because the data used to establish the child support guidelines in most states only consider the costs of raising a child, the financial obligations of the nonresidential parent tend to be understated. Some costs incurred by the residential parents such as employment limitations are not recognized.<sup>123</sup> These costs are much more appropriately recognized as a child support obligation than as alimony, especially because alimony ends with remarriage but these costs continue and, therefore, so should the payments from the nonresidential parent. In effect, when parents conceive children, the parents incur an obligation--a debt--to provide their children with support during their minority with the cost being shared by the parents. The contribution of the parents to these costs can be time as well as money.

*C. Marital Property*

Marriage is a joint endeavor in which the spouses share their earnings, skills and energy with one result being the accumulation of marital property, which is a debt--this time of the couple to themselves as individuals. Marital property is usually accumulated by a couple saving, as they sacrifice current consumption.<sup>124</sup> Basically, couples have two options for their after-tax income: they can spend it or save it. By saving, they are able to acquire property such as mutual funds or a house from which they expect future benefits. But saving is usually a sacrifice, because people would generally prefer to have the immediate benefits of consumption. Both spouses make a sacrifice in anticipation of the future benefits from the saving. Calling marital property a debt would not change the outcome for the items currently recognized as property from what usually happens in most states because the community property perspective has tended to become

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<sup>123</sup> See ALLEN M. PARKMAN, NO-FAULT DIVORCE: WHAT WENT WRONG? 136 (1992).

<sup>124</sup> Wealth from gifts and requests is usually treated as separate property rather than as marital property and, therefore, is not divided at divorce. Uniform Marriage and Divorce Act, § 307, Section A, 9A UNIF. L. ANN. 160 (1979).

the norm.<sup>125</sup> After the marital property is identified, it tends to be divided equally. From the perspective argued here, marital property is based on a debt from the couple to themselves as individuals that is satisfied by giving them equal shares of the property. By focusing on when sacrifices occurred would aid in determining whether property was separate and should be returned to its owner or marital and the basis of a debt obligation.<sup>126</sup>

#### *D. Enhanced Earning Capacity*

Another obvious debt occurs when a spouse incurs sacrifices to increase the income earning capacity of the other spouse.<sup>127</sup> At marriage, a spouse has an income earning capacity, which has a value based on that individual's anticipated income. This capacity is very similar to a portfolio of stocks owned at that time and, therefore, should be treated as separate property. Sacrifices, or investments, can occur during marriage that increase that income earning capacity, thereby, creating a debt obligation. An obvious example is education.<sup>128</sup> Spouses usually contribute their earnings to the enhancement of their family's welfare. Most products and services purchased during marriage are for the benefit of both spouses and their children. However, some of one spouse's earnings may be used to increase the income earning capacity of the other spouse, especially through additional education. Usually the intention is to make an investment rather than to confer a gift, because the expectation is that the increased future earnings will benefit the entire family, obviously including the supporting spouse. Funds are being sacrificed that could be used for current consumption. If the marriage is dissolved before the supporting spouse has received a reasonable return on the investment, then there is a debt of the

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<sup>125</sup> CLARK, *supra* note 8 at 595.

<sup>126</sup> These sacrifices can be of time as well as money. Therefore, the spouses' managing of property acquired before marriage converts some of its value into marital property in a manner similar to the conversion that should occur if the spouses make mortgage payments.

<sup>127</sup> In § 4.07 of the ALI PRINCIPLES at 146, an increase in earning capacity is not the basis for a property claim at divorce. However, it can be the basis for a claim for compensatory payments under § 5.05. These payments are based on the difference in the incomes of the spouses after dissolution rather than any analysis of the actual effect on the marriage on their respective earnings capacities.

<sup>128</sup> A more systematic approach to the costs incurred by the supporting spouse would recognize more than just the direct costs of the education such as books, tuition, and living expenses. A major cost of the education is the income sacrificed by the student spouse, which is a cost that is shared by the spouses. See Allen M. Parkman, *An Investment Approach to Valuing Spousal Support of Education*, in RONALD L. BROWN, VALUING PROFESSIONAL PRACTICES AND LICENSE, 2ND EDITION 18-1 - 18-25 (1994 Supplement).

student spouse to the supporting spouse. The amount of the uncompensated debt should be based on the costs incurred due to the education, which includes the direct outlays for books and tuition, the student's living expenses and any sacrificed income of the student spouse.

This approach is preferable to giving the supporting spouse an equity interest in the student spouse based on a share of the student spouse's enhanced earning capacity. Fundamentally, treating the support as a debt is more attractive because the funds probably replaced student loans. In addition, there is no systematic method for determining an appropriate equity interest. When an equity interest is acquired in a commercial setting, there is an arms length transaction establishing the share of the profits going to each participant. Without an arms length transaction, any determination of the appropriate shares of the spouses is arbitrary, which is something we are attempting to avoid.

Student spouses should be responsible for the debt even if it does not result in a higher income. Normally, the education increases the students' income providing the funds for repayment. Even if the students' income does not increase, the education may have been viewed as an enjoyable experience by the students, which is hardly a reasonable basis for permitting them to avoid repayment. Last, if the education did not result in a substantial increase in the students' income, the students were in a better position to be aware of that possibility and, therefore, should be the one to incur that cost. The bottom line is that by making educational support the debt of a student spouse, it is more likely that it will only be pursued if it is expected to produce positive returns either in terms of a higher income or an enjoyable experience.

Another form of enhanced earning capacity is professional goodwill, which provides a case study of the lack of consistency currently in property divisions.<sup>129</sup> Goodwill can be a valuable asset of a business reflecting the enhanced earnings of the business due to a smooth organization or return customers.<sup>130</sup> If the value of the business increases during marriage, that value should be recognized as marital property. Goodwill was expanded to professionals in part because of the obvious injustices that were occurring in the financial arrangements in divorces involving professional spouses. A high income professional could divorce leaving a spouse with limited compensation because the property division was small, alimony was for a limited duration and there was no child support. Although initiated with good intentions, professional goodwill has

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<sup>129</sup> The ALI PRINCIPLES at 152 discuss the difficulty of measuring the goodwill of a professional business without clearly noting the confusion in the law between the goodwill of the business and the goodwill of the professional in the business. The relevant question is whether the earnings of either have increased during the marriage compared to those that could have been expected prior to the marriage. See Parkman, *Professional Goodwill*, supra note 69.

<sup>130</sup> PAUL H. WALGENBACH & ERNEST I. HANSON, FINANCIAL ACCOUNTING 371 (6<sup>th</sup> Ed 1990).

been applied in a highly arbitrary manner to professionals and celebrities, but not to other types of careers.<sup>131</sup> The frameworks used in these situations often violate basic financial principles.

In the goodwill cases, confusion occurs when an increase in income is interpreted as an increase in wealth. An asset has value because of the returns that it provides its owner such as income. Income is a flow over time, while an asset is a stock at a moment in time. When transactions exist, as they do for most tangible property, these transactions provide a basis for determining the property's value. That is not true with human capital. A person can have a low income, but own substantial wealth in the form of human capital. Think about a fourth year medical student who is probably experiencing a negative cash flow, but the present value of that person's future income stream is substantial as they already possess substantial human capital. The courts have interpreted an increase in income during marriage as evidence of an increase in marital property.<sup>132</sup> However, if the increase was one that could have been expected at the time of marriage, then the value of the underlying human capital has not changed in value. If the income that occurs could have been expected then wealth does not change. For example, a stock price rises in 1995 because of higher earnings expected in 1997. In 1997, those higher earnings occur, but there is no reason to expect the stock price to change. Anticipated future earnings only create marital property when they are expected to increase beyond the level that could have been expected at marriage due to efforts made during the marriage.

For a spouse to make a claim on enhanced earning capacity at divorce there should be evidence of that spouse having made some sacrifices. The most obvious examples will be when that spouse has provided educational support, but it can occur when a spouse's efforts are instrumental in their spouse's success. While not sacrificing her career, a wife may incur costs entertaining her husband's clients and superiors.<sup>133</sup> Because the effect of these activities on a career are difficult to determine, they should be scrutinized closely. Consistency, however, would be increased by considering all effects of marriage that enhance a spouse's income, rather

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<sup>131</sup> See Parkman, *Celebrity Divorces*, supra note 11.

<sup>132</sup> In *Elkus v. Elkus*, 572 N.Y.S.2d 901 (A.D. 1 Dept. 1991), opera singer Frederica von Stade's annual income rose from \$2,250 to \$621,878 over the course of her 17 year marriage. However, most of the important factors that lead to her success were already in place at the time of her marriage and there is no evidence that her husband's actions had any significant effect on her ultimate success. In other words, if the income that she earned after marriage was similar to the one that could have been expected at marriage, then her human capital was in place at the time of the marriage and, therefore, should be treated as separate property. *Id.* at 167.

<sup>133</sup> While relying on the equitable distribution statute in Connecticut, that is the argument made by Lorna Wendt during her divorce from General Electric executive, Gary Wendt. See Maggie Gallagher, *A Corporate Wife Earns Her Share of the Profits*, USA TODAY (May 19, 1997) 23A. Later developments in this case are discussed in Betsy Morris, *It's Her Job Too*, FORTUNE 65, February 2, 1998.

than just the educational support considered in the Principles.<sup>134</sup> These debts should not be affected by remarriage or death

### *E. Diminished Earnings Capacity*

Diminished earning capacities occurring during marriage are not recognized systematically at divorce.<sup>135</sup> Even though there are financial arrangements at divorce, people want to believe that marriage is fundamentally a romantic institution. From that perspective, when love lies, people should be permitted to go their separate ways with a minimum of interference.<sup>136</sup> Slowly, it has been recognized that behind the basic attraction between men and women is the fact that marriage is also a pragmatic institution in which spouses usually assume more specialized roles.<sup>137</sup> This specialization can result in a diminished earning capacity for a spouse and, therefore, a debt of the marriage to that spouse.

Each spouse had human capital based on their income earning capacity at marriage that was an asset that should be viewed as separate property. The spouses may decide that the marriage benefits from one of them providing services in the home or making career decisions that will result in their not maintaining the value of their human capital by foregoing additional education or on the job training.<sup>138</sup> It is reasonable during marriage for the spouses to alter their

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<sup>134</sup> ALI PRINCIPLES at 383, § 5.15.

<sup>135</sup> Some authors have seen enhanced and diminished earning capacities as alternative approaches to the same problem. See Herma Hill Kay, *Beyond No-Fault: New Directions in Divorce Reform*, in SUGARMAN & KAY, *supra* note 65 at 31. However, they should be analyzed separately. The method recommended in the § 5.06 of the ALI PRINCIPLES at 317 for compensating a spouse for a loss in earning capacity requires the loss to be based on child care. The compensation is based on the child care period and the difference in the spouses' incomes after dissolution rather than the actual reduction in that spouse's earning capacity.

<sup>136</sup> WEITZMAN, *supra* note 29 at 17.

<sup>137</sup> Allen M. Parkman, *Human Capital as Property in Divorce Settlements*, 40 ARK. L. REV. 439 (1987) and Allen M. Parkman, *The Economic Approach to Valuing a Sacrificed Career in Divorce Proceedings*, 2 J. OF THE AM. ACAD. OF MATRIMONIAL LAWYERS 45 (1986). Other authors have argued that an equally important process has been increased specialization among women. See June Carbone and Margaret F. Brinig, *Rethinking Marriage: Feminist Ideology, Economic Change, and Divorce Reform*, 65 TULANE L. REV. 953, 990 (1991).

<sup>138</sup> Because of a lack of understanding of what constitutes property, some authors have argued that these sacrifices should be considered as part of alimony rather than as part of the

activities or increase their specialization relative to what they would have done if they were not married. Rather than pursue her best career opportunities, a spouse may elect to make concessions that are in the best interest of the family, while not being in her narrowly defined best interest. These sacrifices are particularly obvious when a couple has children, but they can occur in childless marriages. The arrival of children usually results in one parent, usually the mother, increasing the emphasis that she places on work in the home to the detriment of her career. The parents may be tempted to share the responsibility for child rearing, but usually it is less costly to the couple for just one parent to alter his or her employment than for both to alter theirs. Higher paying jobs often require unexpected overtime and travel. If both parents reject that type of employment to be available for child care responsibilities, they may be worse off than if only one parent makes that choice. Lower average wages generally available to women often make the mother the lower-cost provider of child rearing.<sup>139</sup> Because that specialization may potentially reduce her earnings later,<sup>140</sup> the mother would rationally want a long-term agreement to protect herself from the potential costs of that decision. These sacrifices can also occur among childless couples when a spouse's job relocation benefits the couple but requires the other spouse to sacrifice her opportunities.

These arrangements can result in a debt that is very much like an implied contract of indemnification from the couple to the person making the sacrifice. Therefore, if that person's best employment opportunity at dissolution has an annual salary of \$25,000, similarly qualified people who have worked full time throughout the same period are making \$40,000, and it will take the person five years to catchup with that higher salary, she has incurred a loss of \$40,000 if future losses are discounted to present value at 10 percent. Since it is a debt that should be shared by the couple, the husband should pay the wife \$20,000 either in a lump sum or periodic payments. This debt normally should be shared by the spouses unless there was socially unacceptable behavior. This type of behavior occurs when, for example, a woman sacrificed an opportunity that is no longer available based on assurances that the marriage was durable and yet the husband was having an affair that ultimately resulted in the dissolution of the marriage. In that case, the husband should be responsible for the entire debt.

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property division. See Ellman, *supra* note 8 at 42.

<sup>139</sup> The percentage of fathers who assume the primary child care role should increase as women's earnings rise. The ratio of female to male wages for median year round earnings remained in the range from .57 to .61 during the 1960s and 1970s, but this ratio has had a steady increase in the 1980s, rising to .66 in 1987. CLAUDIA GOLDIN, *UNDERSTANDING THE GENDER GAP* 60 (1990). That ratio has continued to increase to .72 in 1993. U.S. BUREAU OF THE CENSUS, *STATISTICAL ABSTRACT*, *supra* note 2 at 477.

<sup>140</sup> See Leslie Stratton, *The Effect Interruptions in Work Experience Have on Wages*, 61 S. ECON. J. 955 (1995) and Joni Hersh and Leslie S. Stratton, *Housework, Fixed Effects, and Wages or Married Workers*, 32 J. OF HUMAN RESOURCES 285 (1997).

The attraction of treating these sacrifices as debts is the reduction in arbitrariness combined with the ex-spouses now having incentives to pursue their best employment and remarriage opportunities. Concerns about computational complexity are often overstated.<sup>141</sup> The courts could take judicial notice of tables of earnings by age group for full time employed men and women by educational levels.<sup>142</sup> These could be compared to the relevant spouse's current best alternative with the expectation that any difference would be eliminated within a period equal to half the duration of the absence from the workforce.<sup>143</sup> As with the Principles,<sup>144</sup> spouses who deviate substantially from the normal situations should be encouraged to draft their own pre or post marital agreement.

This loss is due to *this* marriage and, therefore, should not be terminated with remarriage nor should it be modified.<sup>145</sup> If her human capital is reduced by decisions made during a subsequent marriage, then that reduction will have to be determined if that marriage is dissolved. These personal sacrifices are an important source of the gains from the family for its participants and, therefore, should be encouraged.<sup>146</sup>

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<sup>141</sup> ALI PRINCIPLES at 326, § 506, Comment e. The compensation provided by the Principles is based on the child care duration and the difference in the incomes of the spouses after dissolution. *Id.* at 318, § 506(4). While having the attraction of simplicity, that scheme bares little relationship to the actual sacrifices and, therefore, would be highly arbitrary.

<sup>142</sup> Tables with the mean earnings for year round, full time workers by sex, age and education are available using the Current Population Survey, which is a monthly survey of about 50,000 households conducted by the Bureau of the Census for the Bureau of Labor Statistics.

<sup>143</sup> Part time work could be treated as a half year's absence. Age-earnings profiles initially tend to be steep reflecting the importance of on-the-job training that complements earlier formal education. See BECKER, HUMAN CAPITAL, *supra* note 61. Therefore, there normally should be a fairly rapid convergence between an individual's actual and potential incomes.

<sup>144</sup> ALI PRINCIPLES at 257, Comment b to § 501.

<sup>145</sup> In contrast, the Principles limit compensation to caretaker's of children with an award normally terminating at remarriage. See *Id.* at 317, § 5.06, and at 350, § 5.08.

<sup>146</sup> Allen M. Parkman, *The Deterioration in the Family: A Law and Economics Perspective*, in GARY MELTON, ED., THE INDIVIDUAL, THE FAMILY AND SOCIAL GOOD: PERSONAL FULFILLMENT IN TIMES OF CHANGE (1995) 21. It has been shown that no-fault divorce has encouraged married women to work outside the home often to their and their family's detriment. Also see Parkman, *Married Women*, *supra* note 107.

## V. Consistency After Divorce

Basing the financial obligations at dissolution on debts would also increase consistency after divorce because support and property division obligations are currently treated differently under the Bankruptcy Code (Code).<sup>147</sup> This is especially important because property division obligations, which are less predictable under the Code, have become the preferred vehicle for dealing with the financial arrangements between ex-spouses.<sup>148</sup> Individuals can file for bankruptcy using three chapters of the bankruptcy code:<sup>149</sup> Chapter 7 if they want to discharge their debts and liquidate their nonexempt assets, Chapter 11 if they want to reorganize their financial affairs through a reorganization or Chapter 13 if they want to adjust their debts and they have a regular income. A limited number of people also avail themselves of bankruptcy using Chapter 12, in which the debts of a family farmer with regular income are adjusted. Of primary concern are Chapter 7 and 13 filings. Under the Bankruptcy Code of 1978 (Code), awards or agreements in the nature of support between ex-spouses were non-dischargeable, while obligations arising from property divisions could be discharged in the same manner as ordinary commercial debts.<sup>150</sup> These provisions caused substantial concern because they were viewed as conferring substantial

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<sup>147</sup> See White, *supra* note 12 and Parkman, *Dischargeability*, *supra* note 12.

<sup>148</sup> See CLARK, *supra* note 8 at 589.

<sup>149</sup> For a summary of the bankruptcy code, see MICHAEL J. HERBERT, UNDERSTANDING BANKRUPTCY (1995)

<sup>150</sup> 11 U.S.C. § 523(a)(5) (1988) provided:

A discharge. . . does not discharge an individual debtor from any debt ---

(5) to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation agreement, divorce decree, or other order of a court of record, determination made in accordance with State or territorial law by a government unit, or property settlement agreement, but not to the extent that--

(A) such debt is assigned to another entity, voluntarily, by operation of law, or otherwise (other than debts assigned pursuant to section 402 (a) (26) of the Social Security Act, or any such debt which has been assigned to the Federal Government or to a State or any political subdivision of such State); or

(B) such debt includes a liability designed as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance, or support.

benefits on debtor ex-spouses, especially men.<sup>151</sup> The Bankruptcy Reform Act of 1994 (Reform Act) addresses these concerns by extending the restrictions on the dischargeability of support commitments to most property division obligations in Chapter 7, 11 and 12 cases.<sup>152</sup> Still, obligations based on a property division can be discharged in Chapter 13 cases and even in Chapter 7, 11 and 12 cases under certain circumstances.<sup>153</sup> Under Chapters 7, 11 and 12, property division obligations can be discharged if the debtor does not have the “ability” to pay or the benefit of discharging the debt to the debtor outweighs the detrimental consequences to the

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<sup>151</sup> Suzanne E. Doherty, *The Interplay Between Bankruptcy and Divorce: Which Former Spouse Deserves the Fresh Start?*, 99 COMM. L. J. 192 (1994); Sheryl L. Scheible, *Defining “Support” Under Bankruptcy Law: Revitalization of the “Necessaries” Doctrine*, 41 VANDERBILT L. REV. 1 (1988), Sheryl L. Scheible, *Bankruptcy and the Modification of Support: Fresh Start, Head Start, or False Start?*, 69 N. C. L. REV. 577 (1993), Jana B. Singer, *Divorce Obligations and Bankruptcy Discharge: Rethinking the Support/Property Distinction*, 30 HARV. J. OF LEG. 43 (1993), Ellen B. Vergos, *Bankruptcy Issues Arising in Divorce Practice*, 24 MEM. ST. L. REV. 697 (1994).

<sup>152</sup> For an analysis of the provisions of the Reform Act that affect divorce, see White, *supra* note 12. For a review of recent cases under the provisions of the Reform Act, see Richard H. Maloy, *Does the New Exception to Discharge in Bankruptcy Give the Marital Creditor a Benefit or a Trompe L’Oeil?*, 6 J. OF BANK. LAW & PRAC. 51 (1996).

<sup>153</sup> Bankruptcy Reform Act of 1994, Pub. L. No. 103-394 § 304(e), 108 Stat. 4106, 4133 (codified as amended at 11 U.S.C. § 523 (1994)). Section 523 (a) (15) provides:

(a) A discharge . . . does not discharge an individual debtor from any debt ---

(15) not of the kind described in paragraph (5) that is incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decrees or other order of a court of record, a determination made in accordance with State or territorial law by a government unit unless---

(A) the debtor does not have the ability to pay such debt from income or property of the debtor not reasonably necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor and, if the debtor is engaged in a business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business or

(B) discharging such debt would result in a benefit to the debtor than outweighs the detrimental consequences to a spouse, former spouse, or child of the debtor. . .

creditor.<sup>154</sup> The result is that support obligations will continue to be non-dischargeable, while many property division obligations will continue to be dischargeable.<sup>155</sup>

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<sup>154</sup> If the creditor ex-spouse does not file a timely complaint, the property division debt will be discharge and the opportunity to object to its discharge is lost forever. Margaret Dee McGarity, *When as Ex-spouse Goes Bankrupt*, 91 A.B.A. J. 64 (November 1995).

<sup>155</sup> On further reflection, the Reform Act's limits on the dischargeability of debts other than support may not be big an improvement as promised. See Parkman, *Dischargeability*, supra note 12. The two conditions under which a property settlement debt can be discharged under Chapters 7, 11, and 12 are when the debtor lacks the ability to pay and when the benefits of discharging the debt to the debtor outweigh the detrimental consequences to the creditor. Both present problems for a creditor spouse. First, if the debtor ex-spouse files for bankruptcy, his property division obligations will automatically be discharged unless a determination of non-dischargeability is made by the bankruptcy court based on the timely filing of an adversary proceeding. For the creditor spouse to assert her rights is potentially costly with the result that she may not be willing to assert those rights. As a result, these provisions create a strong incentive for debtor ex-spouses to file for bankruptcy. See C. R. Bowles, *Escaping the Bankruptcy Trap: The Dischargeability of Marital Obligations After the Bankruptcy Reform Act of 1994*, 10 AM. J. OF FAM. LAW 171 (1996). Second, the same income that was available before the divorce to support one household is now supporting two households with the result that both households are incurring financial difficulties. Since only the financial difficulties of debtors are addressed and, since their financial resources can be limited, one can only speculate that it often may be the basis for a discharge based on the debtors' limited ability to pay. The test used in Chapter 13 filings has been adopted by most courts in the context of filings under other Chapters. Most courts are applying the test under 11 U.S.C. § 1325(b)(2) in the context of 11 U.S.C. § 523(a)(15)(A). *Id.* at 177. Other courts have applied the student loan test to the new property settlement exception. See WHITE, supra note 4 at 636. Last, ambiguity leads to additional litigation and the weighing of the benefits of discharging the debt to the debtor and the detrimental consequences to the creditor is very ambiguous. When both parties to litigation have a reasonably clear idea of the outcome of the litigation, they have incentives to settle to avoid the costs of a trial. Alternatively, when outcomes are uncertain, both parties may overestimate their chances of success with the result that they will continue to incur the costs of litigation increasing the probability of a trial. See RICHARD POSNER, *ECONOMIC ANALYSIS OF LAW* 555 (4<sup>th</sup> ed.1992). More litigation is detrimental to all ex-spouses.

A major concern continues to be Chapter 13 because it contains its own non-dischargeable debt provisions that permit the discharge of property division obligations and it was not amended in 1994. 11 U.S.C. § 1328(a) (1994). Non-dischargeable debts under § 1328(a) include long term debts for which the final payment is due after completion of the plan, support obligations, educational loans, and debts for death or personal injury arising out of the debtor's use of a motor vehicle while intoxicated. *Id.* The creditor ex-spouse who is holding a property settlement

However, the distinction between support and property is based on the law rather than the more appropriate financial analysis presented here. From a financial perspective, both are based on debts incurred during marriage. In a business setting, these debts would generally not have been incurred unless they were protected by a security interest with the result that the creditors' interest would be protected even in bankruptcy. Consistency would be increased by recognizing that support and property division obligations have equal standing as debts. Because it is important that the sacrifices which are the basis of these debts be encouraged during marriage, it is important that their repayment be predictable and, therefore, they should not be dischargeable in bankruptcy.

## **VI. Conclusion**

The current financial arrangements at divorce lack a consistent framework resulting in injustices and inefficiencies. The primary cause of these problems is the lack of logic for alimony, a clear understanding of what is property and how it should be allocated, and protection for support and property division obligations after dissolution. This situation could be improved by recognizing the debts incurred during marriage and then using them as a basis for these financial arrangements. Debts are created during marriage when spouses make sacrifices for which future compensation is appropriate or when they become parents, in which case society imposes on them an obligation to support their children. To encourage these sacrifices, when they benefit the family, they should not be dischargeable in bankruptcy.

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obligation must raise good faith objections to the filing of Chapter 13, the plan confirmation, or both in order to prevent discharge of a property division debt under this Chapter. WHITE, *supra* note 4 at 639. It would be naive not to anticipate a substantial increase in Chapter 13 filings by ex-spouses to take advantage of this obvious loophole.