

# Property Settlements as the Cornerstone of Financial Arrangements at Divorce

Allen M. Parkman\*

## I. INTRODUCTION

The publishing of the American Law Institute's *Principles of the Law of Family Dissolution (Principles)*<sup>1</sup> provides an important opportunity to reconsider the financial arrangements at divorce. Of particular concern is the Principles not directly addressing the effect of marriage on the spouses' income earning capacities, their human capital,<sup>2</sup> and its providing compensatory payments with an important role in the financial arrangements at divorce. This article argues that the preferable financial arrangements at divorce should consist primarily of a clearly defined and unmodifiable property settlement with the impact of the marriage on the spouses' human capital being an important component of that property. First, the obligations between the spouses that need to be addressed at divorce are best treated as debts, based on costs incurred—sacrifices made—during the marriage, and, therefore, property.<sup>3</sup> Many of those sacrifices affect the spouses' income earning capacities. Second, a prescribed property award at that time avoids the perverse incentives created by the modifiable and terminable payments provided in the *Principles*. The *Principles* place emphasis on compensatory payments because it attempts to equitably deal with losses due to failed marriages, rather than to encourage potentially successful marriages, which is the preferred goal suggested here.

An initial concern is why there is a need for the changes proposed in the *Principles*. While there has been a revolution in the grounds for divorce as the fault grounds have given way to no-fault in all jurisdictions, there has only been minor changes in the financial arrangements at divorce.<sup>4</sup> Often unappreciated is

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\* Regents' Professor of Management, University of New Mexico. B.A. 1962, Brown University; Ph.D.(Economics) 1973, University of California, Los Angeles; J.D. 1979, University of New Mexico. Regents Professor of Management Anderson Schools of Management, University of New Mexico, Albuquerque, NM 87131.

<sup>1</sup> AMERICAN LAW INSTITUTE, PRINCIPLES OF THE LAW OF FAMILY DISSOLUTION: ANALYSIS AND RECOMMENDATION (Proposed Final Draft) (February 14, 1997).

<sup>2</sup> The value of a person's human capital is the present value of that individual's anticipated earnings. See GARY S. BECKER, HUMAN CAPITAL 11 (3d ed. 11 1993).

<sup>3</sup> Debts frequently take the form of a loan or a bond, both of which would commonly be recognized as property. More generally, on using a debt framework to determine the financial arrangements at divorce. See Allen M. Parkman, *Bringing Consistency to the Financial Arrangements at Divorce*, 87 KENTUCKY L.J. 51 (1998).

<sup>4</sup> Between 1969 and 1985, all the states either replaced the fault grounds of adultery, desertion, and cruelty with no-fault grounds of irretrievable breakdown or incompatibility or added the no-fault grounds to the existing fault grounds. See generally ALLEN M. PARKMAN, GOOD INTENTIONS GONE AWRY: NO-FAULT

the link between the grounds and these arrangements. In effect, the fault grounds resulted in divorces based on mutual consent, since a party desiring a divorce frequently could not establish the fault grounds of adultery, desertion, or cruelty. Consequently, most divorces in that era were the result of negotiations between the spouses that, in effect, could ignore the statutes that governed the financial arrangements. The divorcing spouse had to come up with a package of concessions to induce the cooperation of the other spouse. The initially unwilling spouse could be persuaded—not necessarily enthusiastically—to initiate the divorce if the concessions covered the anticipated financial and emotional costs of divorce. For example, in a community property state, a spouse could demand substantially more than the equal division of property provided for by law to cooperate in a divorce. Because the couples were ignoring the applicable statutes, there was limited pressure to modify them even as they became flawed.

Conditions changed with the introduction of no-fault divorces based on irretrievable breakdown, or, incompatibility as a divorce became available unilaterally to either spouse in most jurisdictions, dramatically reducing the need for negotiations. Seldom could an unwilling spouse expect financial arrangements at trial that differed substantially from those prescribed by law. A particular problem with those laws was that the financial arrangements tended to ignore the effect of marriage on the spouses' income-earning capacities. A primary example of this omission was the reduction in human capital that occurred when spouses limited their careers during marriage, resulting in many divorced women and their children facing dire financial conditions at divorce.<sup>5</sup> The *Principles* are a reaction to this problem. While it is a laudatory goal to shift more resources to the lower income earning spouse—usually the wife—at divorce, the lack of a consistent framework will result in substantial injustices and socially undesirable consequences for divorced spouses.

This paper initially discusses the different perspectives of lawyers and economists on the issues that should be addressed at divorce. It then argues that the economic perspective is the one that would increase social welfare. Last, the *Principles* is compared to that framework.

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DIVORCE AND THE AMERICAN FAMILY (2000).

<sup>5</sup> Lenore Weitzman reported that divorce resulted in a 42 percent increase in the welfare of men and 73 percent decline in the welfare of women. See LENORE J. WEITZMAN, *THE DIVORCE REVOLUTION* (1985). Others questioned the magnitude of the effect and when Richard Peterson re-analyzed Weitzman's data, he concluded that the effects of divorce, while being dramatic, were less substantial with a 27 percent decline for women and a 10 percent increase for men. See Richard R. Peterson, *A Re-Evaluation of the Economic Consequences of Divorce*, 61 AM. SOC. REV. 528 (1995).

## II. AN ECONOMIC PERSPECTIVE ON MARRIAGE

Lawyers and economists tend to have different interests in marriage. Lawyers generally deal with failed marriages, as they seldom are involved in the initiation of or ongoing activities in a marriage. Couples normally only contact lawyers when the marriage is a failure and they want to dissolve it. Then, the question becomes how to distribute the losses that are about to occur—many of which are—psychological and, therefore, unquantifiable. At the most elementary level, two households are going to have more common, fixed costs than just one. Thus, the family members overall are going to be financially less well off than they were in one household. Allocating this loss in welfare is the primary concern addressed by the *Principles*.

Economists are interested in the choices that will increase social welfare, so with regard to marriage—an institution which most people enter optimistically—they are interested in the choices that will result in successful marriages.<sup>6</sup> The preferred decisions increase social welfare because the benefits exceed the costs—they are efficient.<sup>7</sup> The legal arrangements at divorce—both the grounds and the custodial and financial settlement—have a far more important effect on the quality of these decisions than is commonly recognized. Therefore, the preferred financial arrangements at divorce should encourage people to make social welfare enhancing decisions during, and, if necessary, after marriage.

In addition to love and physical attraction, marriages benefit from spouses making decisions based on their family's best interests rather than a narrow concern for their own welfare. Still, economics provides strong evidence that an individual's own self-interest plays a central role in their decisions.<sup>8</sup> A key, therefore, to a successful marriage is an incentive structure that encourages spouses to recognize that their self-interest is best served by addressing the concerns of other family members, especially their spouse. Extending their concern in this way can result in sacrifices by them that will only be rationally incurred if there are corresponding benefits from the other family members.

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<sup>6</sup> Much of this work can be traced to Gary Becker, whose work is summarized in GARY S. BECKER, A TREATISE ON THE FAMILY (1991). See also W. KEITH BRYANT, THE ECONOMIC ORGANIZATION OF THE HOUSEHOLD (1990); and ALESSANDRO CIGNO, ECONOMICS OF THE FAMILY (1991).

<sup>7</sup> Critical decisions are made about marriage in three phases: 1) prior to marriage; 2) during marriage; and 3) after marriage. Prior to marriage, it is important that people make a diligent search for a spouse. During marriage, it is important that the family members consider the welfare of all family members when making decisions. Last, if the marriage is dissolved, it is important that people continue to make decisions in an efficient manner. The grounds for divorce have an important role in the first two areas (prior to and during marriage) with a combination of no-fault grounds early in marriage and mutual consent later providing far better incentives than the current no-fault grounds for essentially all marriages. See Allen M. Parkman, *Reforming Divorce Reform*, 41 SANTA CLARA L. REV. 379 (2001).

<sup>8</sup> For a good introduction to these principles, see N. GREGORY MANKIW, PRINCIPLES OF ECONOMICS (2d ed. (2001)).

To encourage these sacrifices, they should be recognized as debts if the marriage is dissolved. A debt is the obligation of one person to pay or compensate another.<sup>9</sup> It is similar to a loan and, therefore, is a form of property. The legal term *property* describes items that are assets in the financial and economic literature.<sup>10</sup> An asset has value because of its future returns, although it may not necessarily be marketable. Being physically attractive in that context is an asset. Particularly important here are individuals' income earning capacities, their human capital, which are assets and, therefore, property. While the services that give human capital its value can be sold, the asset itself—the person—cannot be sold.

Imposing a debt obligation on the family encourages important sacrifices during marriage, which can be emotional as well as financial. Spouses are encouraged to make these sacrifices based on the expectation that benefits will follow due to reciprocal acts by other family members, or, at least due to the legal arrangements if their marriage is dissolved. 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 in return, often in the future. The essence of marriage consists of reciprocal arrangements. While neither washing the family car by one spouse, nor cooking dinner by the other, will necessarily 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 act 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 the persons incurring the cost. Spouses are more likely to incur these costs if there is a reasonable assurance that they will be compensated, in effect, creating creditor/debtor relationships.

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 the costs.<sup>11</sup> For example, a couple's

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<sup>9</sup> STEVEN H. GEFIS, *LAW DICTIONARY* 53 (1975).

<sup>10</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* 248 (15th ed. 1995). 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>11</sup> Because no-fault divorce permits unilateral divorce often accompanied by limited financial compensation for people—commonly 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

children might benefit from one parent limiting a career to provide important childcare services. The parents might, however, be reluctant to incur the potential cost of limiting a career—sacrificing human capital, if they are not comfortable that the other spouse and the children will compensate them financially and emotionally. 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>12</sup> As a consequence, the parents focus on their careers to the detriment of their children and, potentially, themselves.

### III. THE DEBTS INCURRED DURING MARRIAGE

Spouses incur costs 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. Furthermore, 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. The obligations to their children are the basis of child support which is not discussed here.

### IV. SPOUSAL SUPPORT

An obligation for the financial support of an ex-spouse had some logic when the primary role available for adult women was as a housewife and mother with the result that their primary cost at divorce was the sacrificed opportunity to have married someone else.<sup>13</sup> 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. However, conditions have changed reducing the importance of spousal support. With increased social mobility, the likelihood that a woman would have

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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?*, 18 INT'L REV. L. & ECON. 41 (1998).

<sup>12</sup> Allen M. Parkman, *Unilateral Divorce and the Labor-Force Participation Rate of Married Women, Revisited*, 82 AM. ECON. REV. 671 (1992).

<sup>13</sup> See Margaret F. Brinig & June Carbone, *The Reliance Interest in Marriage and Divorce*, 62 TUL. L. REV. 855 (1988).

married someone with an income similar to her husband's decreased. Moreover, because of the increase in employment opportunities for women, the primary cost of divorce for many women was the reduction in her human capital that resulted from the sacrifices made during marriage that are discussed below. These sacrifices are best treated as debts that are part of a property settlement.

### V. 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 of the couple to themselves as individuals. When couples save, thereby sacrificing current consumption, they accumulate marital property.<sup>14</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 the norm.<sup>15</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 returned to its owner; or marital, and the basis of a debt obligation.

### VI. HUMAN CAPITAL

Marriage can affect spouses' human capital so that a debt obligation exists at divorce. An important debt obligation can result from a spouse's diminished earning capacity during marriage, which has not been recognized systematically at divorce.<sup>16</sup> At marriage, spouses had an income earning capacity—their human

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<sup>14</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, § 501. 307, Section A, 9A UNIF. L. ANN. 160 (1979).

<sup>15</sup> HOMER H. CLARK, JR., *THE LAW OF DOMESTIC RELATIONS IN THE UNITED STATES* 595 (2d ed. 1988).

<sup>16</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 STEPHEN D. SUGARMAN & HERMA HILL KAY, *DIVORCE AT THE CROSSROADS* 31 (1990). However, they should be analyzed separately. The method recommended in § 5.06 of the 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 childcare period and the difference in the spouses' incomes after dissolution rather than the actual reduction in that

capital—that was an asset. This capacity is very similar to a portfolio of stocks owned at that time and, therefore, should be treated as separate property. The spouses may decide that their 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 due to their foregoing additional education or on the job training.<sup>17</sup> These sacrifices are particularly obvious when a couple has children but they can also occur in childless marriages. The arrival of children often 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. Higher paying jobs often require unexpected overtime and travel. If both parents reject that type of employment to be available for childcare 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>18</sup> This specialization tends to reduce earnings later.<sup>19</sup> 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. The spouses normally should share this debt 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. This loss is due to this marriage and, therefore, should not be terminated with remarriage nor should it be modified.<sup>20</sup> If a spouse's human capital is reduced by decisions made during a subsequent marriage, then that reduction will have to be determined if that marriage is dissolved.

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spouse's earning capacity.

<sup>17</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 property division. See Ira M. Ellman, *The Theory of Alimony*, 77 CAL. L. REV. 1, 42 (1989).

<sup>18</sup> The percentage of fathers who assume the primary childcare 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 continued to increase to .72 in 1994. Francine D. Blau, *Trends in the Well-Being of American Women, 1970-1995*, 36 J. ECON. LIT. 112, 129 (1998).

<sup>19</sup> See Leslie Stratton, *The Effect Interruptions in Work Experience Have on Wages*, 61 S. ECON. J. 955 (1995); and Joni Hersh & Leslie S. Stratton, *Housework, Fixed Effects, and Wages of Married Workers*, 32 J. HUM. RESOURCES 285 (1997).

<sup>20</sup> In contrast, the PRINCIPLES limits compensation to caretaker's of children with an award normally terminating at remarriage. See PRINCIPLES, *supra* note 1, § 5.06, and § 5.08, at 350.

Marriage also can increase a spouse's human capital resulting in a debt obligation. This debt arises from a spouse incurring a sacrifice to increase the income earning capacity of the other spouse.<sup>21</sup> At marriage, a spouse has an income earning capacity, which has a value based on that individual's anticipated income. Sacrifices, or investments, can occur during marriage that increase that income earning capacity, thereby, creating a debt obligation. An obvious example is education.<sup>22</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 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.<sup>23</sup>

In summary, the attraction of treating these important sacrifices during marriage as debts is to encourage spouses to consider the best interests of their family rather than just their narrowly defined self-interest. Since these debts have been incurred during marriage, their value should be determined at divorce. Concerns about computational complexity are often overstated.<sup>24</sup> The courts

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<sup>21</sup> In § 4.07 of the 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>22</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 32 (3rd ed. (1998)).

<sup>23</sup> 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 ones 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.

<sup>24</sup> PRINCIPLES, *supra* note 1, at § 506, at 326, Comment e. The compensation provided by the Principles is based on the childcare 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 bears little relationship to the actual sacrifices and, therefore, would be highly arbitrary.



could take judicial notice of tables of earnings by age group for full time employed men and women by educational levels.<sup>25</sup> Since the data for women reflect that they tend to have lower earnings, due to their increased specialization in domestic activities, it would be appropriate to adjust the potential earnings when considering the cost incurred by a particular woman. These earnings could be compared to the spouse's current best alternative.<sup>26</sup> Normally, the spouses should share a debt. While a property settlement could consist of periodic payments, its value should be determined at divorce with as much of an award as possible covered by assets available then. Spouses who deviate substantially from the normal situations should be encouraged to draft their own pre- or post-marital agreements. Our next concern is whether the *Principles* reflect this framework.

## VII. REFORMS BY THE AMERICAN LAW INSTITUTE

The *Principles* lack consistency, paying no heed to the framework presented above. Sacrifices during marriage are only indirectly addressed, an analysis of human capital is ignored, and compensatory payments are given a central role. The financial arrangements at divorce are addressed in Chapter 4 (Division of Property Upon Dissolution) and Chapter 5 (Compensatory Spousal Payments). Lacking a clear understanding of what is property, it states that the choice of a remedy—alimony or property settlement—for dealing with a compensable loss at divorce is essentially a question of implementation and convenience, rather than one of basic principle.<sup>27</sup>

### A. Property

When the *Principles* consider the division of property upon the dissolution of marriage, it defines marital and separate property, but not property itself.<sup>28</sup> It assumes that the traditionally recognized marital property should be divided equally,<sup>29</sup> except when there is financial misconduct.<sup>30</sup> The major omission is the lack of a definition of property as it states that it would have to define it:

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<sup>25</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. See U.S. BUREAU OF THE CENSUS, MONEY INCOME IN THE UNITED STATES 1999, Current Population Report 60-209 (Sept. 2000).

<sup>26</sup> Age-earnings profiles initially tend to be steep reflecting the importance of on-the-job training that complements earlier formal education. See BECKER, *supra* n.2, at 233.

<sup>27</sup> PRINCIPLES at 10.

<sup>28</sup> *Id.* at 90.

<sup>29</sup> *Id.* at 196, § 4.15(b).

<sup>30</sup> *Id.* at 213, § 4.16.

[I]f 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>31</sup>

Nothing could be further from the truth. When people were making their own financial arrangements at divorce, which was common with fault divorce, a clear definition of property was not essential, or for that matter very important. However, that is no longer the case. 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,<sup>32</sup> for example, should be treated at divorce is due to the lack of a clear definition and understanding of property; especially human capital, something that can be remedied easily using the language of the financial and economic analysts who usually identify and value property. Property is just another word for assets and the obligations between spouses can often be viewed as debts.

If we view marriage as a partnership, the *Principles*' basic framework which divides marital property and returns separate property has a basic appeal. Because the *Principles* does not clearly define property, it does not address the effect of marriage on the spouses' human capital, their earning capacities. The recharacterization of separate property as marital property goes beyond current rules on transmutation and lacks a logical basis.<sup>33</sup>

### B. Compensatory Payments

Since the primary concern of the *Principles* is with an equitable sharing of the losses from the dissolution of a marriage, a primary basis for compensation is periodic payments, which—while having an aura of fairness—can be extremely unfair and certainly inefficient. Having rejected including intangible assets, such

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<sup>31</sup> *Id.*

<sup>32</sup> For a discussion of professional goodwill, see Allen M. Parkman, *A Systematic Approach to Valuing the Goodwill of Professional Practices*, in RONALD L. BROWN, VALUING PROFESSIONAL PRACTICES AND LICENSE 6-1 (3rd ed.1998).

<sup>33</sup> PRINCIPLES, *supra* note 1, § 4.18, at 238.

as spousal income earning capacity among the items considered in property settlements, the *Principles* assigns their relevance to be considered in compensatory awards.<sup>34</sup> The primary emphasis in adjustments at divorce is given to alimony, or compensatory spousal payments, that are based on compensating a spouse rather than on need.<sup>35</sup> Some awards are fixed at dissolution, while others can be modified and terminated with remarriage or death. These payments would provide compensation for a loss in living standard in long duration marriages, in earning capacity due to childcare or care for a third party; 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>36</sup>

Compensation for investments in the other spouse's earning capacity assistance in recovering premarital living standard after the dissolution of a short marriage cannot be modified and does not terminate with remarriage or death.<sup>37</sup> An award can be made in the form of an enhanced share of the marital property, a lump sum from separate property, or a set term of monthly payments.<sup>38</sup> These awards are similar to the debt framework recommended above and, therefore, they should be considered part of the property settlement. Because the *Principles* lack a consistent framework, it does not appreciate that an application of section 5.16 (Restoration of Premarital Living Standard After a Short Marriage) to longer marriages would eliminate the need to consider the issues addressed in sections 5.05 (Compensation for Loss of Marital Living Standard) and 5.06 (Compensation for Primary Caretaker's Residual Loss in Earning Capacity). The financial loss experienced by spouses due to the dissolution of this marriage is the difference between the income that they can now anticipate and the income that they would be earning if they had never married.<sup>39</sup> This loss will be due to a variety of choices made during marriage including those associated with care for children and parents. While a potential criticism of the framework that is suggested above is that it is computationally complex, the inclusion of section 5.16 in the *Principles* is recognition that these calculations are not impossible, even though the period analyzed is extended beyond just short marriages.

Because the *Principles* do not recognize the potentially broad application of section 5.16, compensatory spousal payments are also provided for a loss in living standard after a long duration marriage, or in earning capacity due to care for others. These payments end with remarriage or death<sup>40</sup> and can be modified.<sup>41</sup>

<sup>34</sup> *Id.* at 146, § 4.07.

<sup>35</sup> *Id.* at 259, § 5.02.

<sup>36</sup> *Id.* at 271, § 5.03.

<sup>37</sup> *Id.* at 406, § 5.17.

<sup>38</sup> *Id.*

<sup>39</sup> Drinnig & Carbone, *supra* n.13.

<sup>40</sup> PRINCIPLES, *supra* note 1, § 5.08, at 350.

<sup>41</sup> *Id.* at 357, § 5.09.

Compensation is based on a sharing of the spouses' post-dissolution incomes, although the income transfer often has only a limited link to the sacrifices made or losses incurred.<sup>42</sup> The *Principles* do not provide a logical reason why ex-spouses' incomes should be shared just because they were married even if there is no discernable sacrifice involved.<sup>43</sup> Working at home during marriage is only a basis for these payments if the couple has children<sup>44</sup> or the marriage is for a long duration.<sup>45</sup>

Income sharing is a poor structure for the financial arrangements at divorce. It creates disincentives for ex-spouses to seek their best employment opportunity since they have to share their income with their ex-spouse. The *Principles* want to ignore the most basic aspects of human nature, such as self-interest. Each dollar earned by either ex-spouse has to be shared with the other creating a strong disincentive to earn it. While the reaction of the higher income spouse may be more obvious, the effect on the lower income spouse may be more important since their potential income is not evident at divorce. Having often sought more flexible employment for the benefit of their family, they now have to pursue often less attractive, but higher paying employment. Since any increase in income will reduce the compensation from their spouse, they have a disincentive to make these choices.

Moreover, since some of the periodic payments end with remarriage or cohabitation, the spouse receiving them has less incentive to attempt to establish a new relationship. Finally, there are the inevitable problems associated with collecting periodic payments that could have been avoided if more of the financial transfer had been completed at the time of the divorce with a property settlement.

Not only will the *Principles* encourage inefficient decisions, numerous injustices are likely to occur because the analysis of earnings and sacrifices are not considered. First, there is a lack of understanding of the basis for different earnings. Among workers with similar attributes, those willing to work harder and accept jobs with less attractive attributes tend to have higher earnings. Consequently, it can be unfair to force a higher paid ex-spouse to subsidize a lower paid ex-spouse.

Second, injustices will occur because sacrifices are not considered. All long-term marriages would result in compensatory payments regardless of whether

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<sup>42</sup> *Id.* § 5.03, at 280; § 5.06, at 317.

<sup>43</sup> J. Thomas Oldham, *ALI Principles of Family Dissolution. Some Comments*, 1997 LL. L.R. 801, 815 (1997). If we view a divorce as the breach of a marriage agreement, the *Principles* provides a remedy based on the expectation at the end of the marriage rather than even the expectation at the beginning of the marriage. Even if one wants to use an expectation framework rather than the reliance one suggested here, the expectation should be based on the parties' expectation at marriage. For a discussion of contract remedies, see RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 130 (5th ed. 1998).

<sup>44</sup> *PRINCIPLES*, *supra* note 1, § 5.06, at 335, Reporter's Notes. Comment a.

<sup>45</sup> *Id.* at 319, § 5.06.

there were sacrifices during the marriage. Important sacrifices also can occur before marriage. A woman, who made numerous sacrifices before marriage to acquire important income earning skills, such as a medical education, may be forced to share her income with a man who did not make similar sacrifices either before or during marriage. Moreover, if a spouse limits a career to provide important services in the home and that loss is recognized at dissolution as the basis for compensatory payments, it will not disappear even if the person remarries when the *Principles* would normally terminate compensation.

Injustices will also occur because the *Principles* assume that the lower income earning spouse is the one who is due compensation. 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 future 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 spouse even though it is that spouse who incurred a sacrifice because of the marriage.<sup>46</sup> While the *Principles* permits couples to contract around these provisions,<sup>47</sup> experience has shown that people are reluctant to contract over emotional relationships such as marriage.

#### VIII. CONCLUSION

Our goal with respect to marriage should be to encourage decisions before, during, and after marriage that increase social welfare. The financial arrangements at divorce are important in determining the quality of decisions during marriage. People expect to be compensated for sacrifices that they incur for the benefit of their family. Since these sacrifices essentially create debt obligations, they are best handled through the property settlement. A property settlement also has the important advantage of not distorting the decisions of spouses after their divorce. The *Principles* do not recognize that these sacrifices create a property obligation at divorce. It places an important emphasis of modifiable and potentially terminable payments that will frequently be unjust, confronting ex-spouses with perverse incentives.

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<sup>46</sup> *Id.* § 5.06, at 325, Comment d.

<sup>47</sup> *Id.* § 5.01, at 257, Comment b.