Equitable Distribution: Classification of Student Loans as Marital Debt

Marital debt is debt incurred during the marriage by either or both spouses for the joint benefit of the parties. *Huguelet v. Huguelet,* 113 N.C. App. 533 (1994). The party asking that the debt be classified as marital has the burden of proving the value of the debt on the date of separation and that the debt was incurred during the marriage for the joint benefit of the parties. *Miller v. Miller,* 97 N.C. App. 77 (1990).

In 2015, I wrote about the classification of marital debt in this blog post, https://civil.sog.unc.edu/equitable-distribution-classification-of-marital-debt/. I discussed the decision of the North Carolina Court of Appeals in the case of *Warren v. Warren*, 241 N.C. App. 634 (2015), wherein the appellate court affirmed the trial court's classification of wife's student loan debt as marital debt. In doing so, the court held that to establish that the loans were incurred for the joint benefit of the parties, the party seeking the marital classification has the burden of proving that the loans resulted in a tangible benefit to the marriage. The court in *Warren* stated:

"In order for the court to classify student loan debt as marital debt, the parties must present evidence regarding whether the marriage lasted long enough after incurring the debt and receiving the degree for the married couple to substantially enjoy the benefits of the degree or higher earnings."

The North Carolina Court of Appeals recently revisited the classification of student loans, this time student loans incurred in the name of the husband during the marriage for the education of the adult daughter of the parties. In *Purvis v. Purvis*, (November 16, 2021), the court of appeals again affirmed the trial court's classification of the debt as marital but this time the court held that no tangible benefit to the marriage is required to establish joint benefit.

Purvis v. Purvis

During the marriage, the daughter of the parties attended Sweet Brier College. To pay for the expense of her education, the daughter incurred student loans in her name and husband incurred student loans in his name. The loan proceeds were used by the daughter for tuition, books and living expenses. The parties made a joint decision to incur the loans to help the daughter, but they decided that the loans would be in the sole name of the husband due to discrepancies in the credit scores of the parties. The parties made payments on the loan during the marriage using funds from their joint checking account. On the date of separation, the outstanding debt for the loans incurred by husband was $164,163.00.

In the equitable distribution proceeding, wife moved for summary judgment on the issue of the classification of the loan debt, arguing that the loans were the separate debt of husband. The trial

court denied her motion and ruled that the loan balance was a marital debt. Wife appealed, arguing that husband failed to establish that the debt was incurred for the joint benefit of the parties.

Joint Benefit

The court of appeals affirmed the trial court after concluding that the student loan debt was incurred for the joint benefit of the parties. The court explained:

“Here, the parties do not dispute that there was a joint agreement to incur the debt. Nor do the parties dispute that [wife] actively participated in obtaining the loans. The parties’ affidavits demonstrate there was a joint benefit, in that their daughter’s tuition, books, and living expenses were covered by the loan rather than out-of-pocket expenses. Further, providing [their] daughter with a formal education was something that [they] both wanted and agreed, to do.”

The court distinguished appellate decisions from Nebraska and Rhode Island that classified student loan debt for adult children as separate debt, explaining that those cases involved situations where one spouse did not know about the debts at the time they were incurred and did not consent to the loans at the time they were incurred.

The court in *Purvis* also explicitly addressed the issue of the lack of a tangible benefit to the marriage, stating:

“Although this is not a tangible benefit in that the [student] loans were not deposited in the parties’ account, a tangible benefit is not required under North Carolina law. *Warren v. Warren*, 241 N.C. App. 634, 637, 773 S.E.2d 135, 137-38 (2015) (“Although our Courts have not specifically defined what constitutes a joint benefit in the context of marital debt, this Court has never required that the marital unit actually benefited from the debt incurred.”).”

Despite citing the *Warren* decision, the court of appeals in *Purvis* offers no explanation for the seemingly contradictory statement in that earlier decision regarding the need to show that the marriage benefited from the higher educational degree received by wife as the result of her student loans.

Equitable Distribution: Change in Federal Law Regarding Military Pensions Part 1

Before 1981, military pensions were not subject to division by state courts in marital dissolution proceedings. However, Congress enacted the Uniformed Services Former Spouses Protection Act (USFSPA) to provide that, for pay periods after July 25, 1981, "disposable retired pay" of military personal is subject to division by a state court in a divorce proceeding. 10 USC 1408(c)(1). Effective December 23, 2016, Congress has changed the definition of "disposable retired pay" as it relates to property distribution upon divorce in a way that has left family law practitioners and judges across the country struggling to quickly determine how to reconcile existing state law with the new federal definition. In this blog post, I will try to explain the change as it relates to North Carolina equitable distribution law. In my next post, I will discuss some issues and questions arising from the change.

The Change to Federal Law

Before the effective date of this amendment, the USFSPA defined "disposable retired pay" as "the total monthly retired pay to which a member is entitled less [certain specified] amounts."

The 2016 amendment adds that the:

"monthly retired pay to which a member is entitled shall be—

"(i) the amount of basic pay payable to the member for the member's pay grade and years of service at the time of the court order, as increased by

"(ii) each cost-of-living adjustment that occurs under section 1401a(b) of this title between the time of the court order and the time of the member's retirement using the adjustment provisions under that section applicable to the member upon retirement.".

National Defense Authorization Act for Fiscal Year 2017, sec. 641; PL 114-328, December 23, 2016, 130 Stat 2000.

Before this amendment, state courts had the authority to order a division of any portion of a service member's disposable retirement pay, even if retirement occurred many years after the property division and the total disposable retired pay reflected years of continued service following the state property division. The new amendment means that state courts now have authority to distribute only that portion of a member's final retirement pay that would have been paid to the service member had she or he retired on the date of the entry of divorce plus any cost of living adjustments that occur between the time of divorce and the actual retirement of the service member.

How does this affect North Carolina law?

It appears that this change will not affect either the classification or the valuation of a military pension in a North Carolina equitable distribution proceeding.

G.S. 50-20.1 requires that all pensions be classified using the coverture fraction; the numerator of the fraction represents the number of years of the marriage, up to the date of separation, which occurred simultaneously with the employment that earned the pension, and the denominator represents the total number of years during which the pension accrued up to the date of separation. So for example, if one spouse has been employed by the same company earning a pension for 10 years by the date of separation, and the parties were married for 5 of those years, we know that 5/10ths or one half of the date of separation value of the pension is classified marital property. *See Bishop v. Bishop*, 113 NC App 725 (1994); *Robertson v. Robertson*, 167 NC App 567 (2004). Because classification is determined as of the date of separation and the date of separation always will be before the date of divorce, the federal change to the definition of disposable retired pay will not affect the classification of any pension under North Carolina law.

Similarly, North Carolina law requires that pensions be valued as of the date of separation by assuming that the military service member retired on the date of separation. *Bishop*. So again, because the date of separation always will be before the date of divorce, the change to the federal law will not result in a change in the value of a pension under North Carolina law.

What about distribution?

In *Seifert v. Seifert*, 319 NC 367 (1987), the Supreme Court approved of the use of a very common application of the distribution method authorized by GS 50-20.l(a)(3) and (b)(3). Referred to as “the fixed percentage method” or “deferred distribution,” these statutes authorize the court to make an award of pension benefits payable “as a prorated portion of the benefits made payable to the designated recipient at the time the party against whom the award is made actually begins to receive the benefits.” The *Seifert* court approved use of a specific fraction to determine the “prorated portion of benefits” to be paid in the future. The fraction is the total time earning the pension while married up to the date of separation over the total time earning the pension up to the time of actual retirement.

This fraction is applied to the total disposable retired pay of a service member, which until December 2016 was defined to mean the total retirement pay of the service member at the time of actual retirement. Service members have argued that application of a fraction such as the one approved in *Seifert* inappropriately allowed the non-service member spouse to share in increases in retirement benefits earned by the service member spouse after the date of separation. The court in *Seifert* rejected this argument, holding instead that using a fraction that takes into account the total employment time earning the pension makes “deferral of payment … possible without unfairly reducing the value of the award [to the nonemployee spouse]… and [allows] the nonemployee

spouse [to] share in any growth in the benefits [earned during the marriage]."

The recent change in the federal definition of disposable retired pay will significantly affect the amount of benefits that will be received by a former spouse of a retired service member if the fraction approved in *Seifert* continues to be used. That is because the fraction will be applied to a smaller number, the amount of retirement pay the service member would have received if he or she retired on the date the divorce judgment was entered plus cost of living adjustments that accrued between that date and the actual date of retirement.

Consider an example. Wife joins the military shortly after marriage. Parties separate after 20 years and the court decides the pension is 100% marital and husband should receive 50% of the marital portion. Wife stays in military until she retires with 30 years of service. Her disposable retired pay under the old definition (and the amount she actually will receive even with this new definition applicable only for the purpose of property distribution upon divorce) is $3000 per month. Application of the *Seifert* fraction to the $3000 will result in payment to husband of $1020 per month. [20 years/30 years times 50% times $3000 = $1020]

However, application of the fraction to the new definition of disposable retired pay means that, assuming for the sake of a simple illustration that the divorce judgment is entered the same year the parties separate, husband will be awarded a portion of a 20 year retirement benefit plus cost of living adjustments rather than a portion of a 30 year benefit. Let's assume for this example that this amount would be $2200. When wife retires after 30 years, husband will receive $748 per month rather than the $1020 he would have received before the legislative change. [20 years/30 years times 50% times $2200 = $748].

This Raises Some Questions

I think the first legal issue to address is the question of whether application of the *Seifert* fraction in light of this change results in distributions that may be inherently unfair to the non-military spouse. If so, does North Carolina law actually require that we use the *Seifert* fraction or are judges and litigants free to determine the "prorated portion of the benefits made payable to the designated recipient at the time the party against whom the award is made actually begins to receive the benefits" in some other way?

I will write about that in the next blog. In the meantime, let me know if you have thoughts about any of this.

Equitable Distribution: Change to Federal Law Regarding Military Pensions Part 2

In my last blog post, I wrote about a recent change to federal law regarding the portion of a military pension subject to division by a state court in a divorce proceeding. Effective December 23, 2016, the definition of disposable retired pay in the context of a division of a military pension in a marital dissolution proceeding found in 10 USC sec. 1408 was amended to be the amount a service member would have received had he retired on the date of divorce plus cost of living adjustment accruing between the date of divorce and the date of actual retirement. Before amendment, the definition of disposable retired pay was the total amount a service member receives upon actual retirement, regardless of whether that amount reflected years of service and elevations in rank of the service member following the date of divorce.

The change in the definition of disposable retired pay does not appear to impact the way we classify and value a military pension under North Carolina equitable distribution law, but the change does raise issues regarding how military pensions actually are divided between the parties when the fixed percentage, deferred distribution method of division is used.

Distribution Methods

In Seifert v. Seifert, 319 NC 367 (1987), the Supreme Court explained the difference between the immediate offset method of distributing a pension and the fixed percentage, deferred distribution method. In the immediate offset method, the pension is valued and distributed to the service member whose employment earned the pension. The other spouse receives more marital property to offset the value of that spouse's marital interest in the pension that is distributed to the service member spouse. This method is not the most common distribution method because it requires that there be sufficient other marital property to offset the value of the pension. In most cases, the value of a marital pension far exceeds the rest of the marital estate. If the immediate offset method is used to accomplish an equitable distribution, the recent change to the federal law will not affect the process at all.

The fixed percentage, deferred distribution method is far more common. The division of the marital portion of a pension is accomplished by the entry of an order designating the portion of each future retirement check that must be paid to the non-service member former spouse when the service member retires and begins to receive retirement benefits. The *Seifert* court approved of the use of a fraction to determine the portion of each future pension check payable to the non-service member spouse. In that case, the fraction was to be applied to the total retirement pay received by the service member upon retirement, an amount determined by his rank and years of service at the time of retirement. The recent change in federal law means that the fraction set out in our division orders now will be applied to a lesser amount, the amount the service member would be receiving

had he or she retired on the date of divorce** plus any cost of living adjustments accruing between the date of divorce and the service member's actual retirement date.

Do we need to modify the *Seifert* fraction?

The fraction used in Seifert had a numerator that was the amount of time earning the pension while married up to the date of separation and a denominator that was the total time the service member spent earning the pension up to the time of his retirement.

While the *Seifert* court decided that application of this fraction to award the non-service member a share of the total pension earned by the service member up to the date of retirement was fair because it protected the non-service member's interest in the growth of the marital interest over time, application of this same fraction to the lesser amount now authorized by federal law will result in a dilution of the non-service member's marital interest. For a discussion of this dilution effect that at least one appellate court concluded is unfair to the non-service member spouse, see Douglas v. Douglas, 454 SW3d 591 (Tex. App. 2014). To avoid this dilution, the denominator of the fraction must be the total time earning the benefits that actually are being divided rather than the total time earning all the benefits the service member will receive. With the change in the federal law, the benefits actually being divided are only those earned by the service member up to the date of the divorce.

Can we apply the *Seifert* formula this way?

I think so. The court in Seifert defines the denominator of the fraction used in that case as "the total period of participation in the plan." I do not think it is inaccurate to interpret this definition to mean the total period of participation in the plan "earning the amount being divided." That certainly is what the court meant considering the facts in Seifert, but the amount being divided in that case was the member's full retirement pay. If we define the amount being divided in accordance with the new federal law, the denominator should be the total number of years earning the pension up to the date of the divorce.

Returning to the admittedly over simplistic example from my last post, let's assume we have spouse who served in the military 20 years while married up to the date of separation, 22 years up to the date of divorce and 30 years by the time of actual retirement. Also assume the non-service member is awarded 50% of the marital portion of the pension. The fraction as applied in Seifert was 20/30 times 50% times the disposable retired pay received by the service member when he retires. If the disposable retired pay is the service member's full retirement, Seifert says that is fair. But if the fraction is applied to the reduced disposable retired pay now required by the federal law, using 30 years as the denominator dilutes the share of the non-service member spouse. To accurately account for the marital interest in the amount actually available for division, the denominator should be 22 years rather than 30.

Other pensions

A change in the fraction may take care of the unfair dilution. However, courts and practitioners also should remember when fashioning distributions that this change in federal law applies only to military pensions. So, if one spouse has a military pension and the other has, for example, a North Carolina state employee pension, the *Siefert* fraction still will be applied to the state employee's full retirement benefits at the time of retirement while the amount of the military pension to be divided will be the reduced disposable retired pay.

Should courts and practitioners somehow adjust the distribution to account for this difference? This is a difficult question to answer because the difference in the two pensions will not be reflected in their valuation within the context of the equitable distribution proceeding. For this reason, we cannot assume that the military pension is somehow less valuable than the state employee's pension. Even if it is less valuable, if we use the correct fraction to designate the portion of the military pension that should be paid to the non-service member spouse, how significant will the difference be between what the military pension would have been before the federal law change and what it is now, especially when we add in the cost of living adjustments? That certainly is not something to be considered without actual evidence in each individual case.

I would love to have comments from those of you with more experience actually drafting division orders. Are there other issues raised by this change in the federal law?

**I use the term divorce judgement because the Uniformed Services Former Spouses Protection Act, 10 USC 1408, defines the term court order as "a final decree of divorce, dissolution, annulment, or legal separation issued by a court, or a court ordered, ratified, or approved property settlement incident to such a decree judgment." The amendment changing the definition of disposable retired pay fixes the pay at the time of "the court order".

Military Disability Pay: It's not marital property but it is income

In an opinion issued yesterday, the NC Court of Appeals reaffirmed that while military disability pay cannot be distributed by a court in equitable distribution, it is income that can be considered when the trial court is looking for a source of payment for a distributive award. Lesh v. Lesh, NC App (Jan. 16, 2018). In reaching this decision, the court rejected the argument that this rule was changed by the recent decision by the US Supreme Court in Howell v. Howell, 137 S. Ct. 1400 (2017), wherein the Court reiterated that federal law prohibits the distribution of military disability in equitable distribution.

Lesh and Howell present a good opportunity to review the law regarding military disability pay in domestic relations cases.

Military Disability Pay Cannot be Distributed in ED

The federal Uniformed Services Former Spouses' Protection Act authorizes states to treat veterans' "disposable retired pay" as property divisible upon divorce, 10 U. S. C. §1408, but the definition of disposable retired pay does not include disability benefits. Therefore, federal law prohibits the distribution of military disability benefits in equitable distribution proceedings. *Mansell v. Mansell*, 490 US 581 (1989). Military disability pay is the separate property of the veteran. Lesh; *Hillard v. Hillard,* 223 N.C. App. 20 (2012); *Halstead v. Holstead*, 164 NC App 543 (2004); *Bishop v. Bishop*, 113 NC App 725 (1994).

Retirement Can Be Converted to Disability and There's Not Much A Trial Court Can Do About It

Unless a retired service member qualifies for concurrent pay pursuant to 10 U.S.C. § 1414(a)(1)(most retirees with at least 20 years qualifying service and a service-related disability of at least 50%), a service member cannot receive both disability pay and retirement pay. This means that many service members must waive retirement pay in order to receive disability pay. Many disabled service members decide to "convert" their retirement pay to disability pay when they become eligible to do so because disability pay is not taxed and cannot be distributed in divorce proceedings.

A service member can waive retirement for disability at any point in time after a service member becomes entitled to receive disability pay. If the conversion occurs before a court enters an order for equitable distribution, the court can consider the disability payments as a distributional factor but cannot give dollar-for-dollar "credit" in distribution to make up for any retirement pay lost due to conversion to disability. *Halstead v. Halstead,* 164 N.C. App. 543(2004).

A service member retains the right to convert retirement to disability even after a state court has awarded a portion of the member's retirement pay to the member's former spouse in an equitable distribution judgment. When this conversion occurs, the amount of retirement pay received by the former spouse of the service member generally is reduced. A trial court may not prohibit a service member from converting retirement pay to disability in the future. *Cunningham v. Cunningham,* 171 N.C. App. 550, 558 (2005).

However, North Carolina appellate courts as well as appellate courts in other states have held that federal law does not restrict the ability of a state court to enforce a judgment dividing military retirement pay entered before a service member converted the retirement pay to disability pay. Therefore, amendments to retirement distribution orders made by trial courts to "effectuate" the terms of the original court order have been upheld. In *White v. White,* 152 N.C. App. 588 (2002), the court of appeals held that the trial court had authority to hear wife's motion to amend a qualified domestic relations order (QDRO) to seek an increase in her share of husband's remaining retired pay to offset the amount of retirement waived by the serviceman. And, in *Hillard v. Hillard,* 223 N.C. App. 20, 24 (2012), the court of appeals affirmed the trial court's decision to amend the ED order after the service member waived retired pay to receive disability pay to require the service member to pay wife "the portion of his retirement required by the previous order." According to the court of appeals, this order did not impermissibly distribute disability pay, as the service member could fund payments from source of his choice.

The recent decision by the US Supreme Court in *Howell v. Howell* rejected this reasoning by state courts and effectively overruled both *White* and *Hillard*.

Howell v. Howell

An Arizona trial court awarded Sandra Howell 50% of John Howell's future Air Force retirement pay, which she began to receive when John retired the following year. About 13 years later, John elected to waive about $250 of his retirement pay per month in order to receive that amount in disability pay. This election resulted in a reduction in the value of Sandra's 50% share of his retirement pay. Sandra petitioned the Arizona court to enforce the original divorce decree and restore the value of her share of John's total retirement pay. The state court held that the original divorce decree gave Sandra a vested interest in the pre-waiver amount of John's retirement pay and ordered John to ensure that she receive her full 50% without regard for the disability waiver. The Arizona Supreme Court affirmed, holding that federal law did not pre-empt the family court's order.

The Supreme Court reversed and held that a state court may not order a veteran to indemnify a divorced spouse for the reduction in the value of the divorced spouse's portion of the veteran's retirement pay caused by the veteran's waiver of retirement pay to receive disability benefits. The Court held that federal law completely prohibits states courts from treating waived military retirement pay as divisible property because the waived retirement becomes disability pay. The fact

that the waiver occurred after entry of the division order and the state court was attempting to "indemnify" or "reimburse" Sandra for the "vested right" she received when the division order was entered did not change the basic nature of the trial court order. According to the Court, a state court cannot "vest [a right in a party] which [that court] lack(s) the authority to give."

The Court explained that since there is nothing a state court can do to prohibit the conversion or to compensate the non-military spouse after a conversion, the contingency of a conversion is something a state court should consider when valuing the retirement account in the property distribution proceeding. In addition, the court suggested that the loss to the non-military spouse resulting from a conversion may be the basis for a reconsideration of alimony.

But Disability Pay is Income

In Lesh, the trial court classified husband's military disability pay as separate property but considered the disability pay as a source of income available to husband to pay a distributive award. Husband argued on appeal that this judgment violated Howell because it effectively required him to "reimburse" or "indemnify" wife for the retirement she lost when he accepted the disability pay.

The court of appeals disagreed, pointing to another decision by the US Supreme Court. In *Rose v. Rose*, 481 US 619 (1987), the Court explained that the fact that disability pay must be classified as separate property does not mean that it is not income to the receiving party and held that a veteran's disability income could be considered as a source of income from which he could pay his child support obligation. According to the Court, there is nothing in federal law indicating "that a veteran's disability benefits are provided solely for that veteran's support." *See also Comstock v. Comstock*, 240 NC App 304 (2015)(U.S. Trust IRA was separate property due to federal law but was a liquid asset the court could consider as a source of payment of a distributive award); and *Halstead v. Halstead,* 164 N.C. App. 543(2004)(military disability pay is separate property that can be considered as a distribution factor in ED proceeding).

Equitable Distribution: significant legislative amendments regarding retirement accounts and other forms of deferred compensation

North Carolina S.L. 2019-172 (H 469) made substantial revisions to GS 50-20.1 governing the classification, valuation and distribution of pension, retirement and deferred compensation benefits. The changes apply to distributions made on or after October 1, 2019.

Types of benefits subject to the provisions in GS 50-20.1. The legislation changes the title of GS 50-20.1 from "Pension, retirement and *other* deferred compensation benefits to "Pension, retirement and deferred compensation benefits" to clarify that the provisions in the statute apply to all forms of deferred compensation plans rather than only to those deferred compensation benefits that are in the nature of a retirement account. In addition, GS 50-20.1(h) is amended to specify that the statute applies to all vested and nonvested pension, retirement and deferred compensation plans, programs, systems of funds, specifically including but not limited to "uniformed services retirement programs, federal government plans, State government plans, local government plans, Railroad Retirement Act pensions, executive benefit plans, church plans, charitable organization plans, individual retirement accounts within the definitions of Internal Revenue Code sections 408 and 408A, and accounts within the definitions of Internal Revenue Code section 401(k), 403(b), or 457."

Classification. Until this amendment, the statute required that all accounts and benefits subject to GS 50-20.1 be classified by the coverture fraction. The coverture fraction is a simplistic formula that conclusively defines the marital portion of the date of separation value of an account by applying a fraction to the total value of the benefits on the date of separation; the numerator of that fraction being the total time married while earning the pension and the denominator being the total amount of time earning the pension up to the date of separation. So for example, if a spouse worked for state government for 5 years before marriage and 5 years during marriage with a total of 10 years of employment by the date of separation, the coverture fraction provides that one half of the value of the government pension on the date of separation is marital and one half is separate.

The legislation amends GS 50-20.1(d) and adds new section (d1) to distinguish the classification methodologies for defined benefit plans from defined contribution plans.

Defined benefit plans. The statute continues to provide that a defined benefit plan will be classified by the coverture fraction.

- A defined benefit plan is a plan wherein the benefits payable to the participant are determined in whole or in part based upon the length of the participant's employment. An example of a defined benefit plan is a government or military pension.

Defined contribution plans. New section GS 50-20.1(d1) requires that a defined contribution plan be classified through tracing rather than by application of the coverture fraction. A defined contribution account is an account wherein the benefit payable to the participant spouse is determined by the contributions contained in an account with a readily determinable balance. Examples of defined contribution accounts include 401(k) plans and 403(b) plans.

- Tracing means classifying an account by establishing through evidence how much of the account balance on the date of separation was the result of marital contributions and growth on marital contributions and how much of the account balance on the date of separation was the result of separate contributions and growth on separate contributions. If insufficient evidence is presented to allow the court to classify the marital portion of the account by tracing, the court is required to determine the marital portion of the defined contribution plan by application of the coverture fraction.

Valuation

- **Defined benefit plan**. The legislation changes the requirement that a defined benefit plan be valued as of the date of separation in all cases. GS 50-20.1(d) was amended to specify that if the marital portion of a defined benefit plan (for example, a military or other government pension) is divided equally between the parties and the benefits are distributed by an order that directs the payment of benefits to each party in the future when the plan participant is eligible to receive benefits, begins to receive the benefits, or reaches the earliest retirement age, the court is not required to identify the date of separation value of the pension before classifying it and entering a distribution order.
- **Defined contribution plan**. The statute continues to require that defined contribution plans be valued by the account balance on the date of separation.

Distribution

Benefits vested on the date of separation. The legislation amends GS 50-20.1(a) to allow the court to distribute vested defined contribution accounts:

- as a lump sum from the account (agreement of the parties is no longer required), or
- by ordering the payment of fixed amounts payable over time (also no longer requires

agreement of the parties).

Both a vested defined benefit plan and a vested defined contribution plan can be distributed:

- as a prorated portion of the benefits payable at the time the plan participant is eligible to receive the benefits, begins to receive the benefits, or at the participant's earliest retirement age, or
- by awarding a larger portion of other marital assets to the party not receiving the benefits and a smaller portion to the party receiving the benefits, or
- if the parties agree, as a lump sum, or over a period of time in fixed amounts.

Benefits not vested on the date of separation. Both a nonvested defined benefit plan and a nonvested defined contribution plan can be distributed:

- as a prorated portion of the benefits payable at the time the plan participant is eligible to receive the benefits, begins to receive the benefits, or at the participant's earliest retirement age, or
- if the parties agree, as a lump sum, or over a period of time in fixed amounts.

Military Retirement Benefits. The legislation addresses the application of the "frozen benefit rule" to the division of military retirement benefits. The "frozen benefit rule" was created by an amendment to federal law in 2016. That amendment and the effects of that amendment on the distribution of military benefits is discussed in this blog post: Equitable Distribution: Change in Federal Law Regarding Military Pensions Part 1.

The new legislation addresses the federal law by amending GS 50-20.1 to specify that the fraction included in a military retirement account division order will direct the payment of a percentage of the benefit that is:

"determined using the proportion of time the marriage existed (up to the date of separation of the parties) simultaneously with the total time of the employment which earned the benefit subject to equitable distribution to the total time of employment, *as limited or restricted by the plan, program, system, fund, or statute that earned the benefit subject to equitable distribution."*

Deferred Distribution and Survivor Annuities (deferred distribution is when the plan is distributed by the award of a prorated portion of the benefits payable at the time in the future when the plan participant is eligible to receive the benefits, begins to receive the benefits, or at the participant's earliest retirement age):

The legislation adds new sections GS 50-20.1(f1), (f2), (f3) and (f4) to:

- Require that when deferred distribution is used to distribute marital benefits and the plan

permits the use of a “separate interest” approach, there is a rebuttable presumption that the “separate interest” approach will be used. A separate interest approach is a method of dividing the benefits in a way that gives the spouse who is not the plan participant an interest in the plan that allows the nonparticipant spouse to receive benefits in a manner independent from the participant spouse, or to make elections concerning the receipt of benefits independently of any elections made by the participant spouse.

- Give the court the discretion to award all or a portion of a survivor annuity to the nonparticipant spouse and to allocate the cost of the survivor benefit between the parties when the plan does not permit the “separate interest” approach.
- Require that whenever a plan does not automatically provide preretirement survivor annuity protection for the nonparticipant spouse, the court must order the protection if permitted by the plan; and
- Allow the court to allocate equally between the parties any fees assessed by the plan in processing any domestic relations order.

Jurisdiction of the trial court to correct division orders

The legislation also adds new section GS 50-20.1(i) to allow the court, upon motion of a party, to enter a “subsequent order clarifying or correcting its prior order” when a plan has deemed a division order to be unacceptable to divide the plan benefits.

Jurisdiction of the court to enter division order without an ED claim being filed

The legislation adds new section GS 50-20.1(j) to authorize the filing of a claim, either as a separate civil action or as a motion in the cause in an action brought pursuant to Chapter 50, requesting an order effectuating the distribution of a retirement, pension or deferred compensation account in accordance with a valid written agreement between the parties. The new legislation specifies that the court has the authority to enter a distribution order “effectuating the distribution provided for in the valid written agreement” and specifies that the court can enter the distribution order regardless of whether a claim for ED has been filed or adjudicated.

Equitable Distribution: What is Property?

In the recent case of Miller v. Miller, (NC App, April 18, 2017), the court of appeals held that a "Timber Agreement" was "too speculative" to be identified as a property interest in equitable distribution. The agreement between a husband and his cousin provided that husband would receive at some point in the future the value of timber growing on a specific track of land. Citing *Cobb v. Cobb*, 107 NC App 382 (1992), the court stated that the future value of timber that will not mature until many years after the trial should not be considered marital property or a distribution factor, since "characterizing growing trees as a vested property right is far too speculative," and "an equitable distribution trial would become overwhelmingly complicated."

This case raises the interesting question of what exactly is the definition of "property" in the context of equitable distribution?

To be marital property, an item or interest first must be property.

Fortunately, most items in these cases constitute property within the generally recognized meaning of that term. Tangible things, such as houses and other real estate, automobiles, money, jewelry, furniture, etc., clearly are property. Even family pets have been classified as property for purposes of equitable distribution in other states. *See e.g. Bennett v. Bennett*, 655 So. 2d 109 (Fla. Dist. Ct. App. 1995). *See also Shera v. NC State University Veterinary Hospital*, 219 NC 117 (2012)(dog is personal property in North Carolina).

However, the status of intangible rights is less clear. Courts in other states have struggled over whether interests such as job seniority, accumulated sick leave and vacation, frequent flyer miles, the future right to purchase medical insurance in retirement and future inheritance rights constitute property interests that need to be considered in equitable distribution. For more discussion, *see* Brett Turner, Golden, Equitable Distribution of Property, § 5.08-10, 269 (3rd Edition 2005). Regarding inheritance rights in North Carolina, *see Loeb v. Loeb,* 72 N.C. App. 205, 324 S.E. 2d 33 (1985) (allowing consideration as a factor in distribution that wife had a vested interest in a trust, the principal of which would pass to her upon the death of her mother).

Do we have a definition?

The short answer is not really.

North Carolina's equitable distribution statute does not contain a definition of property and the few cases that have addressed this issue have not offered a definition. Further, North Carolina property law does not recognize a general definition that gives the term precisely the same meaning in all contexts. Instead, the definition of property is broad and necessarily varies "according to the subject treated of and according to the context." *Wachovia Bank and Trust v. Wolfe,* 243 N.C. 469,

475 (1956). In other words, whether an interest constitutes property very much depends on whether the question is asked in an equitable distribution case or in a taxation case, for example. Some legal scholars argue that, in general, determining whether an interest constitutes property is as much a question of public policy as anything else. For example, a New York court held that equitable distribution creates a new species of property and that interests should be classified as property if necessary to accomplish the goals of equitable distribution, regardless of the common law definition of property. *O'Brien v. O'Brien*, 489 N.E.2d 712 (1985).

Most dictionary definitions of property indicate that transferability, meaning the ability to exchange the interest for value or to pass ownership to another, is an important characteristic of property. However, North Carolina clearly recognizes items that cannot be transferred or assigned a *market* value as valuable property interests; consider pensions, professional licenses, and interests in closely held businesses and corporations.

Because the concept of property is necessarily broad and non-specific, the law, both in North Carolina and other states, has traditionally identified property interests on a case-by-case basis, weighing the traits of the interest against those traditionally recognized as attributes of property and considering the public policy issues raised by the context of each particular case. *See* Brett Turner, Equitable Distribution of Property, § 5.08-10, 269.

Besides timber contracts, what else is not property in North Carolina ED?

1.VA Loan Eligibility

In *Jones v. Jones*, 121 N.C. App. 523 (1996), the court refused to classify certain veteran benefits as property for purposes of equitable distribution. Defendant argued that his VA loan eligibility should be classified as his separate property. The parties had used defendant's eligibility to obtain a VA loan for the purchase of the marital residence. At the time of separation, the only value of the residence was the VA loan and defendant argued that the court should have "restored" his separate property to him by awarding him the marital residence. The court of appeals rejected defendant's contention that his VA loan eligibility was analogous to military pensions and should likewise be identified as property. The court reasoned that while "[a] military pension is a quantifiable, legally enforceable property interest[,] ...[d]efendant's VA loan eligibility in itself created no enforceable right in defendant other than the right to *apply* for a VA loan. In order to receive a loan, defendant still had to *qualify* for such a loan."

2.Educational Degrees

In North Carolina, professional and business licenses are property but educational degrees are not, at least in the context of equitable distribution. Our case law outside of equitable distribution recognizes professional licenses as valuable property interests entitled to protection under the law, *see e.g., N.C. State Bar v. Dumont,* 52 N.C. App. 1, 15, (1981), and the North Carolina equitable

distribution statute also recognizes professional licenses as property. G.S. 50-20(b)(2) provides that “all professional and business licenses which would terminate on transfer shall be considered separate property.” In *Poore v. Poore*, 75 N.C. App. 414, 423, 331 S.E. 2d 266, 272-73 (1985), the court of appeals held that it was reversible error for a trial judge to fail to classify the defendant’s license to practice dentistry as defendant’s separate property and to consider that property interest when deciding how to distribute the marital property. Further, in a concurring opinion in *Sonek v. Sonek*, 105 N.C. App. 247 (1992), Judge Greene wrote that "[a] professional license is a valuable property right, reflected in the money, effort, and lost opportunity for employment expended in its acquisition, and also in the enhanced earning capacity of its holder ...."

However, in *Haywood v. Haywood*, 106 N.C. App. 91 (1992), *rev'd on other grounds*, 333 N.C. 342 (1993), the court of appeals held that defendant's masters degree in economics and business was not property, stating that "[b]ecause educational degrees, like professional and business licenses, are personal to their holders, are difficult to value, cannot be sold, and represent enhanced earning capacity, the vast majority of states which have addressed the issue have held that such degrees are not property for purposes of equitable distribution." The court acknowledged that the equitable distribution statute specifically defines professional and business licenses as property, but rather than distinguishing degrees from licenses, the court held that by not including degrees in the definition of separate property along with licenses, the General Assembly evidenced a legislative intent that educational degrees not be recognized as property.

3.Contingent Contract Rights

In *Godley v. Godley*, 110 N.C. App. 99 (1993), defendant was a party to a contract which granted him the right to receive a portion of the profits earned by a business in exchange for his consulting services. By the date of separation, he had finished providing the consulting services but the amount he would receive as compensation was uncertain due to the fact that the company had yet to realize the profits upon which defendant's commission would be based. The court of appeals characterized defendant's right to receive the commissions as "a mere contractual right to receive an uncertain amount of commissions at some indefinite time in the future, if at all," and held that the commission was "too speculative" to be distributed or considered in distribution.

Like the recent *Miller* case, the court in *Cobb v. Cobb*, 107 NC App 382 (1992), was faced with the issue of whether the future value of timber being grown on marital property should itself be classified as marital property. The parties had planted trees on their property in 1971, they divorced in 1989, and evidence indicated that the timber would be ready for clear cut in 2007, at which time the owner would realize approximately $174,300 from the sale of the timber. Defendant argued that the projected earnings from the timber should be classified as marital property. The court, however, held that the right to receive the profit from the timber sale in the future was "far too speculative" to characterize as a "vested property right," and held that the future interest could not be classified as marital property nor considered as a factor in distribution. In support of its conclusion, the court pointed to the risk that the future value might not be realized "if, for example, the trees are

destroyed by fire or insects, or if [the owner] decides to sell the property or to not cut the trees at all."

However, in *Christensen v. Christensen*, 101 N.C. App. 47, 50, 398 S.E. 2d 634, 636 (1990), the court identified a management contract for future services as a valuable asset of a business. The contract at issue in *Christensen* provided for services to be rendered for a specified period of time (40 years) and the amount to be paid for the services was certain ($36,000 per year).

Likewise, in *Smith v. Smith*, 111 N.C. App. 460, 433 S.E. 2d 196 (1993), the court indicated that a contract to redeem stock was a vested property interest where the sale price and time for payment was clearly identified in the contract.

Equitable Distribution: The Marital Property Presumption

Immediately following the definition of marital property in G.S. 50-20(b)(1), the statute states "[i]t is presumed that all property acquired after the date of marriage and before the date of separation is marital property except property which is separate property under subdivision (2) of this subsection." This presumption probably is the most important core principle of classification of property in North Carolina equitable distribution because it defines the burdens of proof.

Why is the burden of proof important?

Appellate courts consistently have held that the party claiming a particular classification of property has the initial burden of presenting evidence to support the classification and to support the court's valuation of the asset. *See Johnson v. Johnson*, 317 NC 437 (1986); *Brackney v. Brackney*, 199 NC App 375 (2009). A trial court must identify and classify "property as marital or separate depending upon the proof presented to the trial court of the nature of the assets." *Atkins v. Atkins*, 102 NC App 199, 206 (1991). In other words, a trial court is only obligated to classify and value property in accordance with the evidence presented. If neither party meets the burden of proof to establish that the property is marital or that it is separate, the property falls outside of equitable distribution. This means that the property is neither distributed nor considered in distribution, and the parties are limited to seeking common law remedies to determine their respective interests in the property. *Grasty v. Grasty*, 125 NC App 736 (1997)(business); *Johnson v. Johnson*, 230 NC App 280 (2013)(military pension).

Proving property is marital

A party seeking a marital classification for a particular item of property must show that the property was acquired 1) by either spouse or both spouses, (2) during the course of the marriage, and (3) before the date of separation, and that the property was (4) owned by either spouse or both spouses on the date of separation. *Atkins v. Atkins*, 102 NC App 199 (1991). Once the party has met that burden, the statutory marital property presumption applies and the property is presumed to be marital. There is no requirement that a party seeking a marital classification prove that the property is not separate property. *See Uhlig v. Civitarese, unpublished*, 781 SE2d 828 (2016)(explaining that there is no presumption that property is marital until the party seeking the marital classification proves the elements listed above).

The court of appeals has made it clear that a party seeking a marital classification also bears the burden of proving the date of separation net value of the asset. Early appellate opinions held that a trial judge has the affirmative obligation to value marital property and remanded cases to the trial court when there was no finding of value or when there was insufficient evidence of value offered to support a finding. *See e.g. Wade v. Wade*, 72 NC App 372 (1985)(court must value asset even though conduct of defendant made it difficult). However, more recent opinions have clarified that the trial court's obligation to value exists only when there is credible evidence offered by the

parties supporting the value of the asset. *Lund v. Lund*, 798 SE2d 424 (2017); *Johnson v. Johnson*, 230 NC App 280 (2013). Rather than remanding cases to give parties another opportunity to offer proper evidence of value, the court has held that the party with the burden of proof on classification also bears the burden on valuation. Therefore, if credible evidence of value is not offered, the asset cannot be distributed in equitable distribution even when it is clearly shown to be marital property.

For example, in *Grasty v. Grasty*, 125 NC App 736 (1997), defendant wife established that a business titled in the name of plaintiff husband was a marital asset. However, the trial court found her evidence of value of the business to be "wholly incredible and without reasonable basis," and plaintiff offered no evidence of value. The court of appeals held that it was defendant's burden to prove the business marital and to prove its value on the date of separation. Without credible evidence of value, defendant did not meet her burden. Therefore, according to the court, the business "is not subject to distribution … [and] [a]ny interest the parties have in Grasty Service will necessarily pass outside the Act and be determined by alternative means of property distribution …".

The result was the same when wife failed to offer a date of separation value of husband's military pension in *Johnson v. Johnson*, 230 NC App 280 (2013).

The burden to show property is separate property

Just as a party seeking a marital classification of an asset has the burden of showing that the asset fits within the definition of marital property, a party seeking a separate classification has the burden of showing the asset fits within one of the categories of property defined as separate by G.S. 50-20(b)(2). *Watkins v. Watkins*, 228 NC App 548 (2013)(asset is not separate property simply because other party failed to prove it is marital property). Even if the other party has met the burden required to invoke the marital property presumption, if the party seeking the separate classification proves by the greater weight of the evidence that the property falls within one of the categories of separate property, "then under the statutory scheme of N.C.G.S. 50-20(b)(1) and (b)(2), the property is excepted from the definition of marital property and is, therefore, separate property." *Finney v. Finney*, 225 NC App 13 (2013). This is why cases say that if both parties meet their respective burdens of proof, the property is separate property. *Atkins*; *Finney*.

Mixed Assets (such as joint accounts)

The significance of the marital property presumption is especially apparent in the classification of mixed assets, meaning assets that have some amount of both marital and separate value. The presumption often is cited by the appellate courts to support the principle that once a party shows that an asset was physically acquired by one party or both parties during the marriage and before the date of separation and owned on the date of separation, the entire value of the asset is presumed marital. The burden then shifts to the party seeking a partial separate classification to trace the separate component of the asset. As such tracing can be difficult, if not impossible, the

presumption often means that such assets will be classified as entirely marital property.

For example, in *Minter v. Minter*, 111 NC App 321 (1993), the parties owned, among other things, substantial investment accounts and checking accounts on the date of separation which had been opened during the marriage. Earnings from these accounts had been used to purchase other property during the marriage. Evidence showed that defendant had commingled assets he received from three separate inheritances during the marriage with the marital assets in these accounts. There also was evidence that defendant had deposited stock he owned before the marriage into these accounts. Defendant argued that because both inherited property and property owned before marriage is separate property, a portion of the date of separation value of the accounts and of other assets purchased with funds from these accounts should be classified as his separate property. However, both defendant and his expert admitted during the trial that "dollar for dollar" tracing of the separate components of these assets was a "practical impossibility" because of the number of transactions within these accounts during the marriage. Plaintiff did not dispute that defendant had contributed substantial separate property to these accounts. However, the trial court classified all of the assets owned on the date of separation as marital property after finding that defendant failed to meet his burden of proving the value of his separate interest in the accounts and other assets.

The court of appeals upheld the trial court, stating since "there was no dispute that the contested properties were acquired during the marriage and before the date of separation and presently owned," the burden was on defendant to prove that the "source of the property was separate property, …". The admission by defendant and his expert that it was impossible to identify the value of the separate component of the assets on the date of separation was sufficient to support the trial court's conclusion that defendant had failed to meet his burden of proof.

The court reached the same conclusion in *Holterman v. Holterman*, 127 NC App 109 (1998). In that case, plaintiff received two significant inheritances during the marriage. The inherited funds were commingled with marital assets to purchase various stocks, bonds, and bank accounts. The parties owned those stocks bonds and accounts on the date of separation. The trial court classified all of the property owned on the date of separation as marital property, finding that plaintiff had not produced sufficient evidence to trace the separate component of the assets. Citing *Minter*, the court of appeals upheld the trial court, stating:

… the contested assets in the present case were acquired during the marriage. There is competent evidence to support the court's determination that the plaintiff failed to carry her burden of proof to show that the investments were her separate property. Plaintiff was unable to trace her inheritances to the present assets owned joined by the parties at the time of separation.

For similar holdings regarding mixed accounts, *see Carpenter v. Carpenter*, 781 SE2d 828 (2016); *Comstock v. Comstock*, 771 SE2d 602 (2015); and *Clark v. Dyer*, SE2d (2014).

Appreciation of Separate Property

While GS 50-20(b)(2) states that an increase in value of separate property is separate property, case law tells us that an increase in value that occurs as the result of marital effort (an active increase) is marital property. *Wade v. Wade*, 72 NC App 372 (1985). As with other mixed assets such as joint accounts, the marital property presumption applies to place the burden of proving that an increase in value of separate property that occurs during the marriage is passive rather than active falls on the person seeking to have the increase classified as separate. *Conway v. Conway*, 131 NC App. 609 (1998); *O'Brien v. O'Brien*, 131 NC App 411 (1998). In other words, any increase in value of separate property during the marriage is presumed to be marital (active). The owner of the separate property has the burden to prove the increase was not the result of marital effort (passive), which frequently is very difficult to do. For recent application of this rule, see *Porter v. Porter*, 798 SE2d 400 (2017)(husband failed to show any passive appreciation of his investment of separate funds in an LLC so entire increase in the value of his investment was classified as marital).

Marital Debt

The marital property presumption does not apply to the classification of marital debt. The party seeking a marital classification for a debt has the burden to prove the debt was incurred by one or both spouses during the marriage and before the date of separation, the amount of debt owed on the date of separation, and that the debt was incurred for the joint benefit of the parties. *See* blog post Equitable Distribution: The Classification of Marital Debt, June 19, 2015.

Equitable Distribution: Divisible Property and Burdens of Proof

In my last post, I wrote about the marital property presumption and the significance of that presumption in the classification of marital property. Divisible property is not marital property, so the marital property presumption does not apply to help with the classification of property, value or debt acquired after the date of separation. So when there is evidence that marital property has increased in value between separation and the ED trial, does one party have to prove the cause of the increase before the court can distribute the increased value? Or, when one party has received income from a marital asset, like a rental house or an LLC, does one party have to prove that the income was not received as the result of the actions of a party before the court can divide the income between the parties?

Divisible Property

Because the marital estate 'freezes' on the date of separation, *see Becker v. Becker*, 88 NC App 606 (1988), an increase or decrease in the value of marital property occurring after the date of separation, property received after separation, or income received from marital property after the date of separation, is not included in the marital estate. The category of divisible property was created to allow a court to distribute these postseparation assets along with the marital property in some circumstances. If the change in value, new property or income received is classified as divisible, it can be distributed. If it is not divisible property, the court can do nothing more than consider the property, income or change in value as a distribution factor.

Increases and Decreases in Value of Marital Property

GS 50-20(b)(4)a. defines as divisible property:

"[a]ll appreciation and diminution in value of marital property and divisible property of the parties occurring after the date of separation and prior to the date of distribution, except that appreciation or diminution in value which is the result of postseparation actions or activities of a spouse shall not be treated as divisible property."

The court of appeals has held that the "plain language" of this definition creates a presumption that any increase or decrease in the value of marital property after the date of separation and before the date of distribution is divisible property. *Wirth v. Wirth*, 193 NC App 661 (2008). This means that a party who wants the trial court to distribute the increase or decrease between the parties only has to show that marital property increased or decreased in value and the amount of that change. Once the amount of increase/decrease is established, the entire change is subject to distribution unless the other party proves the change in value was caused by the efforts of one of the spouses. *See also Lund v. Lund,* 779 SE2d 175 (2015)(wife met her burden of proof simply by

testifying that, in her opinion, the value of the marital home increased in value by $35,000 since the date of separation. The increase must be classified as divisible property unless husband can show the increase was caused by the efforts of one of the spouses).

The significance of this presumption is illustrated by the result in *Romulus v. Romulus*, 215 NC App 495 (2011). Husband was a dentist and his dental practice was classified as marital property. Evidence showed that the value of the practice increased during separation and wife argued the increased value was divisible property and subject to distribution. Husband argued that his daily work in the practice caused the increase. The trial court made the following findings of fact:

“As to the change in value of John M. Romulus, PA after the separation of the parties, the Court finds that such increase was passive and is thus divisible property. In support of this conclusion, the Court finds that Dr. Romulus' efforts to grow the business were essentially unchanged from DOS until DOT. The Defendant did not invest substantially more time working at his practice than on the DOS, and in fact continued to work “dentist's hours”, which included taking at least one weekday afternoon out of the office or otherwise away from work. There was no evidence of other substantial efforts to grow the business by Dr. Romulus, by increasing advertising, adding new services, new patient recruitment, patient retention efforts or the like.

Even though Dr. Romulus undoubtedly actively worked in the business by going to the office and doing dentistry, that does not lead to the conclusion that the increase in value of his practice is active and his separate property. Take the example of a shopkeeper who runs a corner store. He works from Monday to Friday, 9am to 5pm. A 20 story residential complex is completed across the street and his receipts increase greatly. Contrast that situation with a similar shopkeeper who expands his hours to nights and weekends, increases advertising to capture new customers, and establishes a website offering online shopping and delivery. This shopkeeper sees a similar increase in receipts, without the benefit of the new apartment building across the street. Although both shopkeepers were actively involved in the business of running the store, the increase in the value of the business itself is passive in the first case and active in the other.

Dr. Romulus has not presented sufficient evidence to rebut the presumption that the increase in value of marital property post separation is divisible property, and thus such increase will be classified as divisible property and distributed as set out in this order.”

The court of appeals affirmed the trial court’s conclusion, stating:

“Essentially, the trial court found that it could not determine the cause of the postseparation increase in value, and because of the statutory presumption, it must be considered divisible.”

Other categories of Divisible Property

In addition to increases and decreases in the value of marital property not caused by the actions of

one spouse, divisible property also includes:

All property, property rights, or any portion thereof received after the date of separation but before the date of distribution that was acquired as a result of the efforts of either spouse during the marriage and before the date of separation, including, but not limited to, commissions, bonuses, and contractual rights.

Passive income from marital property received after the date of separation, including, but not limited to, interest and dividends, and

Passive increases and passive decreases in marital debt and financing charges and interest related to marital debt.

GS 50-20(b)(4)b-d.

There is no statute or case identifying a presumption relating to the classification of any of these other categories of divisible property. In a footnote in *Walter v. Walter*, 149 NC App 723, fn 2 (2002), the court stated that the party claiming property to be divisible has the burden of proving "that it is so." This appears to mean that the party asking the court to distribute the property or debt has the burden of proving that the property or debt falls within one of these three definitions and the party must do so without the aid of any presumption.

Passive Income Received From Marital Property

Most appellate cases reviewing the classification of divisible property have involved the first category, increases and decreases in value of marital property. However, there also have been several appellate cases involving one spouse's receipt of income from a marital asset after separation and the question of whether the court had the authority to distribute some or part of that income to the other spouse. Although the appeal was resolved on other grounds, the trial court order reviewed in *Montague v. Montague*, 238 NC App 61 (2014), shows how difficult it can be to differentiate passive shareholder distributions from an employee spouse's compensation for work performed after separation. The burden clearly is on the spouse asking the court to distribute the income to prove the income was completely or at least in part passive. *See also Binder v. Binder*, *unpublished*, 231 NC App 514 (2013)(evidence was sufficient to support trial court's conclusion that part of cash withdrawals from a marital LLC were compensation for husband's postseparation work but that rest were passive shareholder distributions that were divisible property).

While there are no presumptions to help with the classification of income received after separation, the court of appeals has made a couple of broad statements that should be helpful to litigants seeking to have funds classified as divisible property. In *Montague v. Montague*, 238 NC App 61, 65-66 (2014), the court stated that shareholder distributions from an LLC generally are passive income that should be classified as divisible property, and in *Lund v. Lund,* 779 SE2d 175 (2015),

the court of appeals stated that rental income generated from marital property after separation is passive income that should be classified as divisible.

Equitable Distribution: Can the court order the sale of marital property?

The duty of the trial court in an equitable distribution proceeding is to identify, value and distribute the marital and divisible property and debt of the parties. There is a presumption in favor of an 'in-kind' distribution of marital and divisible assets, meaning the law presumes the court will accomplish an equitable distribution by distributing the actual assets and debts between the parties rather than by distributing assets and debts to one and ordering the receiving party to pay the other a distributive award. Despite this presumption, however, distributive awards are common. The presumption in favor of an in-kind distribution is rebutted by evidence the property "is a closely held business entity or is otherwise not susceptible of division in-kind." G.S 50-20(e).

If the court can give all of the property to one and order that spouse to buy-out the other's interest with a cash distributive award, can the court instead order that property be sold with the cash proceeds distributed between the parties? The answer to that question in North Carolina became less clear last week.

Wall v. Wall

The first time the court of appeals addressed this issue directly, it held without extensive discussion that the trial court has the discretion to order the sale of marital property. In *Wall v. Wall*, 140 N.C. App. 303 (2000), the trial court classified and valued the marital home and ordered that it be sold and that the proceeds be used to pay the costs of the sale and to pay all encumbrances on the home. Any remaining proceeds were ordered to be distributed between the parties. The trial court did not offer any specific explanation for ordering the sale, other than to find that both parties agreed the house was marital but they strongly disagreed over value and both wanted the house in distribution.

The court of appeals affirmed the trial court order, stating:

"The defendant argues that the trial court must distribute the home to one of the parties, rather than ordering it sold. We disagree. …

While we have never expressly discussed the trial court's power to order the sale of marital assets as part of an equitable distribution, our prior decisions have implicitly recognized the power of the trial court to do so. *See, e.g., Dorton v. Dorton*, 77 N.C.App. 667, 336 S.E.2d 415 (1985) (trial court did not err in forbidding either party to receive a commission or broker's fee on the sale of the marital home after ordering the home sold); *Soares v. Soares*, 86 N.C.App. 369, 357 S.E.2d 418 (1987) (trial court erred in failing to value the marital home before ordering it sold); and *Thomas v. Thomas*, 102 N.C.App. 127, 401 S.E.2d 367 (1991) (citing *Soares*) for same proposition. We

continue to stress the importance of following the steps of first classifying, then valuing and distributing marital property. Each step is a prerequisite to the performance of the next, and failure to follow the prescribed order will result in a fatally flawed trial court disposition. “[O]nly those assets and debts that are *classified* as marital property and *valued* are subject to *distribution* under the Equitable Distribution Act (Act)....” *Grasty v. Grasty*, 125 N.C.App. 736, 740, 482 S.E.2d 752, 755, *disc. review denied,* 346 N.C. 278, 487 S.E.2d 545 (1997) (emphasis added). Here, there was no dispute over the classification of the marital home as marital property. Further, as we discussed above, the trial court properly valued the marital home prior to its distribution. Rather than distributing the home to one of the parties, the trial court ordered the parties to sell the property by 13 January 1998 and use the proceeds to pay off the costs of sale and the encumbrances on the home; any remaining funds from the sale were to be distributed to plaintiff-wife, with defendant-husband receiving a credit equal to one-half of these proceeds. The trial court classified and valued the Country Club Drive residence before distributing it, and we find no abuse of discretion in the trial court's order that the home be sold and proceeds divided between the parties.”

Several appellate cases after *Wall* remanded judgments where the trial court failed to value the marital home before ordering a sale, but until last week, no appellate opinion revisited the question of whether the court has the authority to order a sale as the method of distributing the marital property.

Miller v. Miller

Unlike the parties in *Wall*, neither party in *Miller v. Miller*, N.C. App (April 18, 2017), wanted the marital residence or another track of marital real property. The parties were able to stipulate to the value of the properties and wife asked the court to order that both properties be sold. The final ED judgment ordered that the properties be listed for sale at a price agreed upon by the parties with all net proceeds from the sale being distributed equally between the parties.

Husband argued on appeal that the trial court erred in ordering the sale and the court of appeals agreed, stating:

“The trial court’s role is to classify, value and distribute the property, not simply to order that it be sold. …

The trial court must value and distribute each parcel of real property to a party, and a distributive award may be needed to equalize the division or to make the distribution equitable. Then the party who receives distribution of the real property is free to keep it or sell it.”

The court in *Miller* did not mention the opinion in *Wall* and relevant distinctions between the facts of the two cases are not discernable from the published opinions.

What do other states do?

According to the treatise, Equitable Distribution of Property, written by Brett Turner and published by Thomson West, “a large majority of states” authorize the court to order the sale of marital assets. 3 Equitable Distribution of Property sec. 9:12, p. 49 (3rd Edition 2005). However, many of the cases cited by Turner indicate that an order for sale must be supported by findings to show that a distribution of the property to one party is not feasible or not equitable for some reason. *See e.g. In re Marriage of McDermott,* 827 N.W.2d 671, 684 (Iowa 2013)(“a forced sale is not a preferable method to divide marital assets because such a sale tends to bring lower prices,” so should not be done without a good reason); *Handy v. Handy*, 338 S.W.3rd 852 (Mo. Ct. App. W.D. 2011)(sale should not be ordered when house can be distributed to one and offsetting other property to the other). *But cf. Doyle v. Doyle*, 55 So. 3rd 1097 (Miss. Ct. App. 2010)(sale was appropriate where there was much dispute over the value of the property and the amount of equity, there was very little equity, many homes in the area were in foreclosure, and neither party could afford an outright purchase of the other’s interest); *Baldwin v. Baldwin*, 905 S.W.2d 521 (Mo. Ct. App. E.D. 1995)(home was most significant asset in the estate, too large for either party, and difficult and expensive to maintain; trial court concluded sale was necessary to protect both parties from extended financial drain).

Equitable Distribution: Can we use the date of separation from the divorce judgment?

Anyone who works with equitable distribution knows that the date of separation is a critical fact that must be established before anything else can be done in the case because it is the date used to define and value the marital estate. The date of separation should be established before the parties spend time and money engaging in the discovery process and definitely must be established before the court begins the process of classifying and valuing marital and divisible property.

So what is the relationship between a date of separation found as a fact in an absolute divorce judgment and the date of separation in the equitable distribution case? If the parties have obtained an absolute divorce and that judgment contains a date of separation, is that date binding on the equitable distribution case? Can one of the parties argue in the ED case that a different date was the actual date of separation?

The North Carolina Supreme Court has told us pretty clearly that, at least in those situations where neither party in the divorce case alleged a date of separation that was less than one full year before the divorce complaint was filed, a date of separation found as a fact in a divorce judgment is not binding on the court hearing the equitable distribution matter because the date of separation was not at issue in the divorce trial. This is true even if the parties actually disagreed as to the actual date of separation in the divorce proceeding and the trial court resolved the issue.

Stafford v. Stafford, 351 NC 94 (1999)

On May 14, 1996, plaintiff Ms. Stafford filed a Complaint seeking absolute divorce and equitable distribution. Mr. Stafford filed an Answer and Counterclaims. As usual, the divorce came on for trial before the equitable distribution. The trial court severed the divorce from the remaining issues in the case and tried the divorce. Plaintiff contended, and the trial court found, that the date of separation was the first week of October 1992. The defendant contended that the date of separation was September 13, 1991.

Defendant husband appealed the divorce judgment, arguing that the trial court erred in determining the date of separation to be October, 1992. The court of appeals dismissed the appeal after concluding it was an inappropriate interlocutory appeal. Defendant argued that the trial court's "determination of the date of separation is so fundamental to an equitable distribution trial that it affects a substantial right," entitling him to an immediate appeal. The court of appeals rejected defendant's argument, stating without explaining that no threat of inconsistent verdicts was present in this situation because "[w]hile the determination of the date of separation may have an impact on the unresolved issue of equitable distribution, the same factual issues are not present." Dissenting, Judge Greene wrote that the appeal did affect a substantial right in part because "the

trial court's determination of the date of separation in the divorce action precludes relitigation of that issue for purposes of equitable distribution."

In a short per curium opinion affirming the majority of the Court of Appeals decision that the appeal did not affect a substantial right and evidently disagreeing with the dissent's assertion that the issue of the date of separation could not be litigated again in the ED case, the Supreme Court held that the date of separation in the divorce judgment was not binding on the ED court because the trial court in the divorce case was not required to determine the date of separation to determine whether to grant the divorce. The court stated:

"A basis for granting an absolute divorce is that the parties must live separate and apart for one year. Regardless of the date of separation, the parties [in this case] have been separated for a period far in excess of one year. Therefore, the date of separation has no bearing in this case on the legality of the final divorce judgment. The contested issue of fact concerning the date of separation is an issue in the [pending] equitable distribution claim…".

Stafford, 351 NC 94 (1999).

Similarly, in the more recent decision in Khaja v. Husna, 777 SE2d 781 (NC App, Oct. 6, 2015), the Court of Appeals reversed a trial court's determination that it was bound by the date of separation found in a summary judgment divorce. The trial court hearing an alimony claim ruled that the date of separation contained in the divorce judgment was "law of the case" and refused to hear evidence of a different date of separation. The Court of Appeals held because neither party alleged that the two had not been separated at least one full year, the trial court was not required to determine the date of separation to resolve the divorce claim. Because the findings in the divorce judgment "went beyond facts necessary to resolve the limited issues before it," the unnecessary findings were not binding in subsequent proceedings.

So what does this mean?

Many divorce judgments are entered in cases where the defendant makes no objection to the entry of judgment and raises no issue regarding the date of separation. Stafford and Khaja seem to tell us that a judgment entered in one of these cases should not contain an actual date of separation as a finding of fact. If the judgment does contain such a finding, the date is not binding in subsequent alimony and ED cases.

A party can request a jury trial in an absolute divorce proceeding on the issue of whether the parties were separated for a year before the divorce action was initiated. GS 50-10(a); McCall v. McCall, 138 NC App 706 (2000). A jury never should be asked to determine a specific date of separation. Such requests have been made in response to the Court of Appeals' determination that a party is not entitled to a jury trial to determine the specific date of separation in an equitable distribution case. See McCall, id.

What if one party to the divorce does allege less than one year of separation?

We do not have case law in North Carolina directly addressing this issue. Both Stafford and Khaja involved situations where, despite the disagreement between the parties about the specific date of separation, both agreed they had been separated a year. However, both Stafford and Khaja remind us that a specific date of separation never is a required finding in a divorce judgment. Even in a situation where one alleges the parties have not been separated a full year, the trial court only needs to determine as ultimate fact that the parties were separated a year. The court never needs to find a specific date to determine whether to grant a divorce. Perhaps this was the meaning of the Court of Appeals statement in *Stafford*, that "the factual issues are not the same" in a divorce case and in an ED case.

If the factual issue resolved in the first proceeding is not the same as that to be resolved in the subsequent proceeding, collateral estoppel does not apply. See State v. Macon, 227 NC App 152 (2013)(collateral estoppel only applies to an issue of ultimate fact determined by a judgment in a previous case when that issue of ultimate fact was necessary to the entry of the judgment). When collateral estoppel does not apply, the court in the subsequent proceeding is not bound by the determination made in the first proceeding.

But if there was a judicial admission in the divorce pleadings ……

Regardless of whether collateral estoppel applies, it seems clear that if a party alleged a specific date of separation in a pleading in the earlier divorce proceeding, judicial estoppel will apply to prohibit that same party from later alleging a different date in the subsequent ED proceeding. See e.g. Pickard v. Pickard, 176 NC App 93 (2006).

Equitable Distribution: QDROs, DROs, and a statute of limitations

In this earlier post, I wrote about whether the 10-year statute of limitations for initiating an action on a judgment bars the entry of a QDRO if the request for the QDRO is made more than 10 years following entry of the equitable distribution judgment. https://civil.sog.unc.edu/so-someone-forgot-to-draft-that-qdro-now-what/

The court of appeals recently answered this question, holding that the entry of a QDRO, or a DRO as discussed further below, is a procedural method of effectuating and completing a judgment rather than a substantive mechanism for enforcement of a judgment. Therefore, a request for the court to enter the order is not an action on a judgment and is not barred by the statute of limitations.

Welch v. Welch (NC App, May 2, 2023)(Welch II)

An equitable distribution consent judgment entered in 2008 ordered that plaintiff transfer one-half of his ownership interest in an IRA to defendant. Plaintiff failed to make the transfer. In 2019, defendant filed a motion for contempt or, in the alternative, for a Rule 70 order directing another person to execute the documents to effectuate the transfer. The trial court dismissed the defendant's motions after ruling that the 10-year statute of limitations in GS 1-47(1) barred all actions to enforce a judgment filed more than 10 years after its entry. Defendant appealed but the court of appeals agreed with the trial court, holding that both the contempt motion and the motion for the Rule 70 order were actions seeking to enforce the ED judgment. Welch v. Welch, unpublished opinion, 278 NC App 375 (2021)("Welch 1"). The court of appeals, however, specifically declined to address the authority of the trial court to enter a domestic relations order to effectuate the transfer.

Following that appeal, defendant filed another motion in the trial court, this time asking the court to enter an "IRA Domestic Relations Order (DRO) pursuant to IRC section 408(d)(6) transferring the current balance of plaintiff's Schwab IRA account" to "effectuate" the equitable distribution judgment and to effectuate her vested property rights in the IRA that were created by the ED judgment. The trial court denied the motion, first concluding that the IRA was not a "qualified retirement plan" pursuant to ERISA and therefore could not be distributed by a QDRO or other order and concluding that defendant's motion was another action seeking to enforce the ED judgment and was therefore barred by the 10-year statute of limitations set out in GS 1-47.

This time the court of appeals disagreed with the trial court and held that the entry of a DRO (domestic relations order) is the appropriate procedural mechanism for distributing an IRA and holding that the statute of limitations does not bar a request for entry of a DRO as a means of effectuating a prior order if the entry of the DRO does not affect the substantive rights of the

parties.

QDRO or DRO??

The court of appeals held that defendant's interest in plaintiff's IRA vested when the equitable distribution consent judgment was entered granting defendant one-half of plaintiff's IRA. GS 50-20.1(g) provides that an interest in a retirement account is distributed "by means of a qualified domestic relations order [a QDRO], or as defined in section 414(p) of the Internal Revenue Code of 1986, or by domestic relations order [a DRO] or other appropriate order." GS 50-20.1(h) specifically states that these methods of distribution apply to the distribution of individual retirement accounts [IRAs].

The court of appeals pointed out that distribution of employer-sponsored retirement accounts subject to the federal Employee Retirement Income Security Act of 1974 (ERISA) require a "special class of DRO" called a qualified domestic relations order (a QDRO) as defined by 29 USC section 1056(d)(3)(A). But IRAs that are not funded by an employer are not subject to ERISA and can be distributed by "a simpler DRO." The DRO will contain whatever findings of fact, conclusions of law, and other information required by the administrator of the specific IRA to be distributed. Contrary to the conclusion of the trial judge, "the IRA does not need to be a qualified retirement plan under ERISA for the trial court to issue a DRO."

The Statute of Limitations

GS 1-47 specifies that the statute of limitations for initiating an action upon a judgment is ten years from the date of entry of the judgment. In the first appeal of this case, the court of appeals held that a motion for contempt and a Rule 70 motion were "actions to enforce a judgment" and subject to the 10-year limitation period. In this appeal, the court held that the request for entry of a DRO is not "an action on a judgment" but rather a request to effectuate or complete the equitable distribution judgment.

As support, the court of appeals quoted the Vermont Supreme Court:

"We simply disagree with the conclusion that entry of a DRO is an attempt to enforce the underlying final divorce order or that the filing of a DRO is an attempt to enforce the underlying final divorce order or that the filing of a DRO constitutes an execution upon the judgment. … [T]he right to obtain the retirement funds awarded in a final divorce order depends upon the approval of a third-party, the plan administrator. There is no 'judgment' to execute or enforce until that step has been taken."

Johnston v. Johnston, 212 A.3rd 627, 636 (Vt. 2019).

Also citing a Michigan appellate court, the court of appeals explained that while the statute of

limitations would apply to an attempt to claim a *substantive* right to retirement benefits granted by a judgment, the limitation statute does not apply to a request for the *procedural* mechanism required to accomplish the distribution ordered by the equitable distribution judgment. *Dorko v. Dorko*, 934 NW2d 644 (Mich. 2019).

Does it matter that the ED judgment did not order entry of a DRO?

It is common for equitable distribution judgments to specifically order that appropriate domestic relations orders be entered to effectuate the distribution of retirement accounts. In Welsh II however, the consent judgment stated that the distribution would happen by way of a "trustee to trustee transfer." The court of appeals noted this but stated that the fact that the judgment did not order transfer by a DRO or a QDRO did not impact the holding in this case. The court explained that the principles outlined in the opinion allow the trial court to enter a domestic relations order to effectuate the judgment, even if the trial court did not specifically order entry of the DRO or QDRO in the equitable distribution judgment.

Equitable Distribution: trial court can consider a Rule 60(b) motion during an appeal; stipulation in pre-trial order revokes a revocable Trust

In *Wenninger v. Wenninger*, decided May 7, 2024, the North Carolina Court of Appeals held that an equitable distribution judgment was void for lack of a necessary party because the parties in the equitable distribution proceeding stipulated in a pre-trial order that certain items of property were held in a revocable Trust and further stipulated that some of the property held by the Trust was marital property. The court of appeals held that the Trust was a necessary party, even though the trial court refused to distribute the items in the Trust because they were not owned by either party.

I wrote about that opinion here: https://civil.sog.unc.edu/equitable-distribution-stipulation-in-a-pretrial-order-makes-revocable-trust-a-necessary-party/

In the more recent opinion in Face v. Face, decided November 5, 2024, the court of appeals again illustrated the importance of stipulations in pre-trial orders. The appellate court in Face held that a stipulation in the pre-trial order that properties were marital property amounted to a revocation of a revocable Trust. Because the Trust was revoked by the pre-trial order and the properties from the Trust were stipulated to be marital property, the Trust was not a necessary party to the equitable distribution proceeding.

Face v. Face

In Wenninger, the pre-trial order specified that property stipulated to be marital was held by a revocable Trust. In Face, the fact that property classified as marital property and distributed by the trial court in an equitable distribution judgment was held by a revocable Trust did not become known to the trial court until defendant filed a Rule 60(b) motion to set aside the judgment after it was entered and notice of appeal had been filed. The Rule 60(b) motion stated that "during the process of preparing materials for use in the pending appeals, … defendant's counsel became aware for the first time, of the existence of the Trust" and that "the existence of this Trust or its legal effect do not appear to have been brought to the attention of the [Trial] Court." Defendant's Rule 60(b) motion argued that because the Trust was not joined as a party, the trial court had no subject matter jurisdiction to enter the equitable distribution judgment concerning property held by the Trust.

The trial court entered an "indicative ruling denying defendant's Rule 60(b) motion" and the court of appeals reviewed this "indicative ruling" along with other issues raised by defendant's appeal of the equitable distribution judgment.

Trial court jurisdiction to consider defendant's Rule 60(b) motion

Pursuant to G.S. 1-294, when an appeal is perfected, the trial court is divested of jurisdiction "upon the judgment appealed from, or upon the matter embraced therein, …." The loss of jurisdiction will relate back to the time of the filing of the notice of appeal if the appeal is properly perfected. *Lowder v. All Star Mills, Inc.,* 301 N.C. 561, 273 S.E.2d 247 (1981).

So how did the trial court in this case have jurisdiction to rule on defendant's Rule 60(b) motion?

The court of appeals has held that a trial court can hear a Rule 60(b) motion following appeal and render an 'advisory' decision indicating how it would resolve the issue if it had jurisdiction to do so. *See Talbert v. Mauney,* 80 N.C. App. 477 (1986)(trial court retains 'limited jurisdiction' to hear and consider what action it would take on a Rule 60(b) motion were an appeal not pending.").

The appellate court also explained the procedure in *Bell v. Martin*, 43 N.C. App. 134, 142, 258 S.E.2d 403, 409 (1979), *rev'd on other grounds*, 299 N.C. 715 (1980):

"[T]he trial court [should] consider a Rule 60(b) motion filed while the appeal is pending for the limited purpose of indicating, by a proper entry in the record, how it would be inclined to rule on the motion were the appeal not pending. At the time the motion is made in the lower court the movant should notify the appellate court so that it may delay consideration of the appeal until the trial court has considered the 60(b) motion. Upon an indication of favoring the motion, appellant would be in position to move the appellate court to remand to the trial court for judgment on the motion and the proceedings would thereafter continue until a final, appealable judgment is rendered. An indication by the trial court that it would deny the motion would be considered binding on that court and appellant could then request appellate court review of the lower court's action. This procedure allows the trial court to rule in the first instance on the Rule 60(b) motion and permits the appellate court to review the trial court's decision on such motion at the same time it considers other assignments of error."

Trial court advisory denial of the Rule 60(b) motion

In Face, the trial court rejected the defendant's argument that the Trust was a necessary party. To support the conclusion that it had subject matter jurisdiction to distribute the property at issue, the trial court explained:

"The Trust was not a necessary party to the equitable distribution action, and the Court had subject matter jurisdiction to distribute the Trust's assets, ...

While "[p]roperty is not part of the marital estate unless it is owned by the parties on the date of separation,"… the Court concludes that the settlors of a revocable trust, like the Trust, retain ownership of the trust res. "[T]he power of revocation is tantamount to ownership of the trust property and of such a nature that it is subject to order of the [C]ourt." ....

In addition to the provisions of the Trust in which the parties maintained individual control over any real property placed in the Trust, North Carolina's trust code reinforces the Court's view that property in a revocable trust remains property of the settlor. Pursuant to N.C.G.S. § 36C-6-602(c), settlors of a revocable trust, like Plaintiff and Defendant, have the power to revoke the trust at any time....

[There is a] distinction between revocable trusts, on the one hand, and irrevocable trusts, on the other. In the case of an *irrevocable* trust, the trust is a necessary party.... [*R*]*evocable* trusts are "will substitutes" and the "rules applicable to wills should, and in fact often do, apply to such trusts." ... By entering into the stipulations concerning the distribution of real property which had been placed in the Trust, the parties were exercising their rights to transfer real property as allowed by the terms of the Trust, and, in essence, … revoked the Trust as allowed by N.C. Gen. Stat. § 36C-6-602(2)(c)."

The court of appeals agreed with the trial court

In affirming the trial court's denial of the Rule 60(b) motion, the court of appeals distinguished the result in Wenninger by explaining that, in that case, the parties stipulated that the Trust held title to the property at issue, making the Trust a necessary party to the equitable distribution proceeding. In Face, the parties stipulated "that the property was titled to them individually and [they] retained complete control of the properties in the Trust." The court of appeals agreed with the trial court that the stipulation in the pre-trial order manifested "clear and convincing evidence of the settlor's intent for the property in the Trust to be distributed between the parties as marital property." Because the pre-trial order revoked the Trust, "the parties as settlors, trustees and beneficiaries retained control of the properties subject to distribution." As the Trust no longer held legal title to the property after entry of the pre-trial order, the Trust was not a necessary party to the proceeding.

Equitable Distribution: Stipulation in a Pretrial Order Makes Revocable Trust a Necessary Party

The North Carolina Court of Appeals recently voided an entire equitable distribution judgment because the trial court denied a motion to add as a party a revokable trust alleged to be a necessary party, even though the motion was made more than three months after the conclusion of the equitable distribution trial. In Wenninger v. Wenninger, decided May 7, 2024, the appellate court held that the equitable distribution judgment was void for lack of a necessary party because the parties in the equitable distribution proceeding stipulated that items of property titled in the name of the trust were marital property, even though the trial court refused to distribute the items because they were not owned by either party.

Wenninger v. Wenninger

A pretrial order entered by the trial court identified the parties' stipulations and allegations as to marital property. The order listed three bank accounts and one car that the parties stipulated were titled in the name of a revocable trust. The parties also stipulated that two of the bank accounts were marital property, but they disagreed over the classification of the last bank account and the car.

At the conclusion of the equitable distribution trial, the trial court announced that the property titled in the name of the trust would not be distributed in the final judgment because the property "was not owned by the parties on the date of separation" and the trust "was not a party to this lawsuit."

More than three months later, the husband filed a motion requesting that the trust be added as a necessary party. The appellate opinion makes no reference to any allegation by husband regarding why the trust property should be classified as marital property; there is no mention of a claim that a constructive trust should be imposed on the property to grant either party equitable ownership of the trust property or of any other legal theory under which the property titled in the name of the trust could be classified as marital property.

The trial court denied the motion on the basis that neither party moved to join the trust before the verdict was rendered. The trial court entered the equitable distribution judgment which did not distribute any of the property owned by the trust and husband appealed.

The lack of a necessary party renders a judgment void.

The court of appeals held that the trial court had no discretion to deny the husband's motion to add the trust as a necessary party because any judgment entered without a necessary party is void. According to the appellate court, the trial court had the obligation to join the trust "*ex mero motu*" at any point in time when the trial court determined that the trust was a necessary party. The failure to

add the necessary party rendered the entire judgment void.

Why was the trust a necessary party in this case?

The court of appeals explained that "when a third party holds legal title to property which is claimed to be marital property, that third party is a necessary party to the equitable distribution proceeding, with the third party's participation limited to the ownership of that property." (quoting *Nicks v. Nicks*, 241 N.C. App. 487 (2015)). According to the appellate court, the trust was a necessary party because the parties stipulated that property titled in the name of the trust was marital property in the pretrial order, and because the trial court has a "mandatory duty to classify and distribute property that all parties agree is subject to equitable distribution."

Does this mean third parties or entities must be added whenever the trial court determines property is not owned by one or both of the parties?

It is clear that when a party requests in a pleading that the court impose a constructive trust or a resulting trust on property titled in the name of a third party or an entity such as a trust or an LLC, or when a party requests that a transfer of property to a third party or entity be set aside as a fraudulent transfer so that the property can be brought into the marital estate, the third party or entity must be joined as a party before the court can litigate that claim. *See Upchurch v. Upchurch*, 122 N.C. App. 172 (1996) and *Nicks v. Nicks*, 241 N.C. App. 487 (2015)

But in the Wenninger case, there is no indication that any such claim was made by either party and unlike in *Nicks v. Nicks*, 241 N.C. App. 487 (2015), the court of appeals does not point to any evidence in the record that would support such a claim.

In *Weaver v. Weaver*, 72 NC App 409 (1985), Ms. Weaver purchased a piano during the marriage with marital funds. The husband claimed that the piano was marital property, but the trial court determined that the parties gifted the piano to their children before the date of separation and therefore did not distribute the piano in the equitable distribution judgment. When the husband appealed, the court of appeals affirmed the trial court, holding that evidence was sufficient to show that the children rather than the parties owned the piano on the date of separation.

Despite the allegation by husband that the piano was marital property, the court of appeals in *Weaver* did not void the equitable distribution judgment because the children were not brought into the action as necessary parties. There was no claim that the transfer to the children should be set aside, so the trial court had the authority to determine that neither party owned the piano without joining the actual owners of the property.

The only difference between *Weaver* and Wenninger appears to be the stipulation of the parties in *Wenninger* that the property of the trust was marital property. Even though the trial court did not distribute the property titled in the name of the trust, the court of appeals held that the fact that the

parties agreed that the property was marital required the court to join the trust as a necessary party, despite the lack of any claim by the parties that would support taking title away from the trust and vesting it in the parties.

So, I hope we don't interpret the Wenninger opinion too broadly. I believe *Weaver* still is good law. Absent a stipulation such as the one in *Wenninger*, there is no need to join third parties or entities unless there is a claim that will support vesting title, either equitable or legal title, in one of the parties to the equitable distribution action.