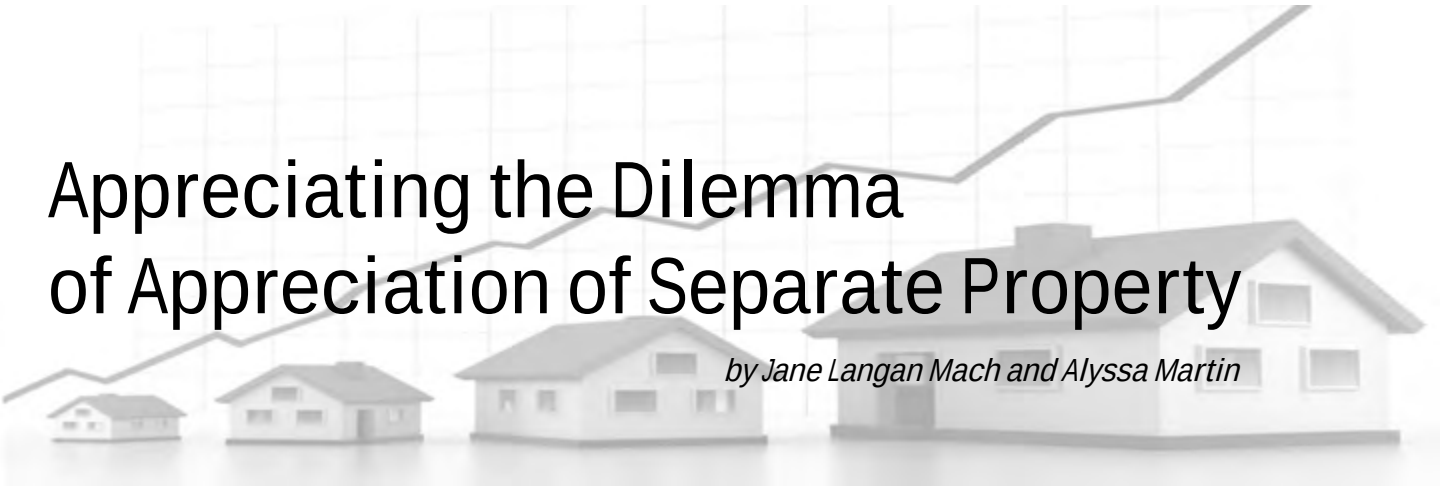

Appreciating the Dilemma of Appreciation of Separate Property

by Jane Langan Mach and Alyssa Martin

Ordinarily, property that a spouse acquires by way of gift or inheritance or property that a spouse acquired prior to marriage is set aside as separate property and not considered a part of the marital estate.[1] A dilemma arises, however, when such separate property appreciates in value during the marriage. How should courts classify such appreciation – marital, separate, mixed? What principles should guide this analysis?

It turns out that Nebraska law is quite unclear on this point. This article describes the current muddled state of Nebraska law; articulates principles that may animate an appreciation analysis; and charts paths forward for the Nebraska Supreme Court.

Muddled State of Nebraska Law

There are two distinct trends in Nebraska law regarding the issue of marital appreciation in separate property. Under the first trend, which is often identified with the 1982 Nebraska Supreme Court case of *Van Newkirk v. Van Newkirk*, 212 Neb. 730 (1982), appreciation in separate property is classified as separate unless "both of the spouses have contributed to the improvement or operation of the property . . . , [or the non-titled spouse] has significantly cared for the property during the marriage" (hereinafter referred to as "the *Van Newkirk* rule").[2] Under the second trend, appreciation in property is classified as marital "to the extent that it was caused by marital funds or marital efforts; otherwise, it remains separate property" (hereinafter referred to as "the active appreciation rule").[3] The latter trend relies on the distinction between "active" appreciation – or appreciation caused by the funds or efforts of *either* spouse – and "passive" appreciation – or appreciation caused by third parties or natural/market forces. Significantly, the former trend requires the non-titled spouse to contribute in some way to the separate property while the latter does not.

What follows is an exploration of these distinct trends, including various sources of confusion latent in the caselaw.

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APPRECIATION OF SEPARATE PROPERTY

1. *Van Newkirk* Trend

Van Newkirk itself embodies these conflicting trends in Nebraska law. *Van Newkirk* involved the disposition of a 320-acre farm that had been gifted to a wife in 1963 and that had appreciated in value during her marriage.[4] The trial court classified as separate property the value of the farm in 1963 and classified as marital property the appreciation of the farm "as determined by the court on the date of trial."[5] The court also classified as marital property the value of the unharvested crops on the farm.[6] The Nebraska Supreme Court reversed, concluding that both the value of the appreciation and the value of the unharvested crops should have been classified as separate property.[7] In so concluding, the Court enunciated the *Van Newkirk* rule and applied the following reasoning:

> Although the evidence indicates that the husband may have spent some limited time on the property in connection with the harvests, it is clear from the record that the increase in value is *due principally to inflation* and *not to any significant efforts by the husband*. . . . We reach the same conclusion with regard to the unharvested crops which were a party of the property. *Neither party* spent much, if any, time in the planting or harvesting of the crops, and it would appear that, having set aside the property to the wife, we should likewise include the crops.[8]

On the one hand, the Court seemed to focus on whether the *non-titled spouse* contributed to the property, as evidenced by its reference to "efforts by the husband" and its enunciation of the principle that the non-titled spouse must contribute to the property in order to have a share in the appreciation.[9] On the other, the Court seemed to focus on whether *either party* contributed to the property, as evidenced by its references to "inflation" and "neither party."[10]

Cases interpreting *Van Newkirk* have glossed over this ambiguity and focused more narrowly on the language of the *Van Newkirk* rule, with its emphasis on the contributions of the non-titled spouse.[11] And the cases have generally interpreted the *Van Newkirk* rule to require that the non-titled spouse provide (i) evidence of the *value* of his *direct* contributions to the separate property, and (ii) evidence that said contributions were significant in nature.[12] For example, in *Applegate v. Applegate*, 219 Neb. 532 (1985), the Nebraska Supreme Court held that the *Van Newkirk* rule did not apply in a situation where the contributions of the non-titled spouse "were typical of a wife of a farmer-cattle raiser" and where the non-titled spouse "did not contribute *directly* to any preservation of or increase in value of the property."[13] Under this line of cases, contributions by the titled spouse are immaterial to the analysis.

Nonetheless, Nebraska courts have found application of the *Van Newkirk* rule to be inequitable in some circumstances. In *Grace v. Grace*, 221 Neb. 695 (1986), the Nebraska Supreme Court stated that the rule articulated in *Van Newkirk* "does not purport to be an ironclad, rigid rule for all circumstances,"[14] and held that the non-titled spouse in that case was entitled to an equitable award notwithstanding the inapplicability of *Van Newkirk*.[15] Such equitable awards have come to be known as "*Grace* awards." The Nebraska Supreme Court has provided little guidance on the appropriate size or circumstances for such awards, creating confusion and inconsistency. As a result, these awards are typically only granted in exceedingly narrow cases involving the following fact pattern:

> [T]he wife devotes herself to running the household and caring for the children [while] the husband's labors are devoted to a family farming or ranching corporation in which he owns stock [that constitutes separate property]. . . . Additionally, in the typical situation where the issue arises, the husband receives a rather nominal cash salary in exchange for his labor devoted to his family's farm or ranch but also receives such things as housing, utilities, vehicles, fuel, beef, use of the corporation's land for his private livestock herd, et cetera. As a result of the low cash earnings of the husband, the couple often has an inconsequential marital estate.[16]

Given this state of the law, commentators have appropriately noted that the *Grace* terrain is a standard-less one.[17]

In addition to the confusion surrounding *Grace* awards, *Van Newkirk* has given rise to confusion about the concepts of *transmutation* and *appreciation*. As the Supreme Court of Alaska observed:

> [A] spouse's premarital property can become marital through transmutation or active appreciation. Transmutation occurs when married parties intend to make a spouse's separate property marital and their conduct during marriage demonstrates that intent. Active appreciation occurs when marital funds or marital efforts cause a spouse's separate property to increase in value during the marriage. In contrast to transmutation, which converts an asset completely from separate to marital, active appreciation recognizes that a separate asset can become partly marital by growing in value during the course of a marriage.[18]

Although *Van Newkirk* itself strictly dealt with the *increase in value* of separate property,[19] courts have applied the *Van Newkirk* rule to the *entire value* of separate property, thus conflating principles of appreciation and principles of transmutation.[20]

2. Active Appreciation Trend

The active appreciation trend is generally of more recent vintage in Nebraska.[21] Outside of Nebraska, the active appreciation rule is the majority rule.[22] In the 2015 case of *Coufal v. Coufal*, 291 Neb. 378 (2015), the Nebraska Supreme Court signaled support for the active appreciation rule, though – as in *Van Newkirk* – the signals were ultimately mixed. In that case, a question arose as to how to classify appreciation in the pre-

marital portion of a husband's retirement account.[23] The Court concluded that the appreciation should be treated as separate property because "[n]o effort from either spouse directly or indirectly affected the [increase in value],"[24] as said increase was guaranteed by statute.[25] Although the Court seemed, in the end, to rest its analysis on an active/passive distinction,[26] the Court also cited *Van Newkirk* and its progeny with approval.[27]

Because the situation in *Coufal* involved no effort from either spouse, the Court could invoke both the active appreciation rule and the *Van Newkirk* rule in its reasoning, as both rules pointed to the same outcome in that situation. Put differently, the Court avoided confronting a situation in which the rules collided – that is, a situation in which the titled spouse, but not the non-titled spouse, contributed to the property – and thus glossed past any inconsistencies between the two approaches.

It is unclear whether and to what extent the Nebraska Supreme Court intended for *Coufal* to apply to other contexts. In *Stanosheck v. Janette*, 294 Neb. 138 (2016), the Court insinuated that the analysis in *Coufal* may be limited to "pension plans, retirement plans, annuities, and deferred compensation benefits,"[28] and the Court emphasized the narrow, fact-specific nature of *Coufal*.[29] Although the Court in *Stanosheck* was reticent to widen *Coufal*'s net, the Court did solidify the role of active appreciation principles in the *Coufal* analysis.[30]

It is also unclear how the Nebraska Supreme Court would deal with a situation in which the appreciation in separate property was *partly* attributable to active forces and *partly* attributable to passive forces. Under a unitary appreciation theory, appreciation is either wholly marital or wholly separate. *Van Newkirk* and its progeny trend toward treating appreciation (and perhaps even the underlying property itself) as unitary.[31] But other jurisdictions that have adopted the active appreciation rule generally do not treat appreciation as unitary,[32] and the Court in Coufal provided some support for a hybrid approach.[33]

At a broad level, Nebraska law is muddled because there are two distinct, conflicting trends in the law – a trend that emphasizes the efforts of only the non-titled spouse (*Van Newkirk*) and a trend that emphasizes the efforts of either spouse (*Coufal*). And there is a great deal of subsidiary confusion regarding *Grace* awards, transmutation, and unitary appreciation.

Going Back to First Principles

To place this issue in context, it is worth examining the principles or rationales that might underlie an appreciation analysis. There are three main principles that might have bearing on this analysis: the fruit of the marital tree principle; the income principle; and the reasonable expectations principle.

APPRECIATION OF SEPARATE PROPERTY

1. Fruit of the marital tree

Under this principle, "[i]f separate property appreciates because of the owning spouse's efforts alone, the appreciation is a fruit of the marital tree, and thus marital property."[34] Underlying this principle is the notion that both parties contribute (in their own ways) to the vitality and success of the marital enterprise, and that disentangling one party's contributions from another's is typically an unsound exercise. If only one party contributes to a business, then the other party may be said to *indirectly* contribute to the business by tending to non-business matters and thereby freeing the other party up to focus on the business. As the New York Court of Appeals stated in this context:

> The Equitable Distribution Law reflects an awareness that the economic success of the partnership depends not only upon the respective financial contributions of the partners, but also on a wide range of nonremunerated services to the joint enterprise, such as homemaking, raising children and providing the emotional and moral support necessary to sustain the other spouse in coping with the vicissitudes of life outside the home. . . . Here, the words 'contributions or efforts' are used in the inclusive, general sense and, if given their natural and obvious meaning, would comprise contributions and efforts of any nature, including those of a spouse as homemaker and parent.[35]

As discussed above, *Van Newkirk* and its progeny give credence only to a non-titled spouse's *direct* contributions to separate property, which flies in the face of the fruit of the marital tree principle.[36]

2. Income

The income principle is, in some sense, a subset of the fruit of the marital tree principle. And that is because income earned during a marriage is perhaps the quintessential example of fruit of the marital tree.[37] Under this principle, if the appreciation of separate property acts as a substitute for income that would otherwise be distributed to the marital estate, then the appreciation should be deemed marital. Brett Turner illustrates this principle in the following way:

> Assume that a husband running a separate property business creates $10,000 in value, and pays it to himself as salary. That payment is clearly marital. Likewise, if the husband pays himself the $10,000 as a dividend, the dividend is marital. Assume, however, that the husband decides to keep the $10,000 in the business. Should the classification of value created by marital efforts be [treated] differently, based solely on whether the value is retained or distributed? The general rule is that it should not. Income and appreciation are fundamentally similar—they are both new value arising from existing property—and they should be classified in the same way.[38]

Note that there is a hint of gamesmanship involved here, as courts ought not look favorably upon titled spouses' gamely disguising what would otherwise be income from separate property as passive appreciation.

Nebraska law provides some support for the income principle. In *Rezac v. Rezac*, 221 Neb. 516 (1985), for example, the Court observed:

> If the [husband's premarital] ownership [of shares in a company] was nominal and there was an increase in the value of the stock during the marriage, or if the increase in value of the stock was strictly an inflationary increase, he would have a good argument that the stock should be viewed as continuing and separate ownership during the marriage and at the time of dissolution. The trial court is justified, however, in treating it differently when the percentage of ownership is substantial and improvements or additions are made to the corporate assets through application of corporate income *which would otherwise be distributed to the party during the marriage*. In this case, had the corporation not made substantial investments in improving its facility, the value of the stock may have remained about the same but this respondent *would have received additional income resulting in marital assets which would be subject to division at the time of the dissolution*. For that reason we find no error in the court's using the appreciated value of the stock at the time of the dissolution for the purpose of property division.[39]

In *Coufal*, moreover, the Court addressed an argument that the appreciation of separate property "was a form of marital income earned during the marriage" and thus should be deemed marital. The Court rejected the argument on the basis that the appreciation "was not contingent on [the titled spouse's] continued employment with the State, but was instead guaranteed by statute prior to the marriage."[40] In other words, the Court found that the income principle was not at play; the Court did not find that the principle was irrelevant.

3. Reasonable expectations

This principle is best illustrated by example. Assume that a woman has spent years trying to grow a business, but the business does not really take off until after she gets married. Assume further that only the woman – and not the new husband – contributed to the business during the marriage. Is it equitable for the new husband to get an equal share of the appreciation? Would such a result accord with the parties' reasonable expectations? Underlying this principle is the notion that a titled spouse may reasonably expect to retain both the value of her separate property and the value of any marital appreciation if the increase in value is largely – or entirely – attributable to her efforts. "[A]n equitable property division of the appreciated value of the property should be a function of the tangible contributions of each party and not the mere existence of the

marital relationship."[41] On this view, marital appreciation in separate property caused by only the titled spouse's efforts may factor into an alimony determination vis-à-vis the non-titled spouse, but should not be distributed as property. In addition, this principle counsels against transmutation of separate property unless there is a clear intent on the part of the titled spouse to convert the separate property to marital property.

Going Forward

The Nebraska Supreme Court is poised to address some of the tensions in this area in *Stephens v. Stephens*, No. A-16-0431. In that case, the wife argued that the appreciation that occurred during the marriage with respect to the husband's premarital businesses ought to be classified as marital.[42] The wife relied on the active appreciation rule and drew heavily on the income principle, as she emphasized the husband's active involvement in the businesses during the marriage as well as the husband's decision to forgo income that would have otherwise counted toward the marital estate (as funds were reinvested in the businesses).[43] The husband contended that the *Van Newkirk* rule, and not the active appreciation rule, was the law in Nebraska, and accordingly argued that the wife did not sufficiently contribute to the businesses.[44] The trial court ruled in favor of the husband, citing *Van Newkirk*, but granted the wife a *Grace* award to mitigate the inequities flowing from application of the *Van Newkirk* rule.[45]

The Nebraska Supreme Court could respond to the uncertainty in this area in several ways. For one, the Court could explicitly overrule *Van Newkirk* and adopt the active appreciation rule, which would likely render *Grace* irrelevant. Doing so would create more consistent and predictable outcomes, not to mention align the caselaw with fruit of the marital tree and income principles.

Alternatively, the Court could retain *Van Newkirk* but adopt a more expansive view of what constitutes a "contribution" on the part of the non-titled spouse. If such contributions included *indirect* contributions, such as tending to the home, then the Court would mitigate some of the inequities that flow from application of the *Van Newkirk* rule. This approach would tend to produce outcomes consistent with the active appreciation approach, as efforts by the titled spouse would almost always be accompanied by at least indirect efforts by the non-titled spouse.

The Court could also choose to employ the *Van Newkirk* rule in some contexts and the active appreciation rule in others. For example, the *Van Newkirk* rule could apply to real property while the active appreciation rule could apply to retirement accounts and the like. It is difficult to conceive of a principled reason for such a distinction, however.

Regardless of what approach the Court adopts, it ought to clear up the confusion concerning transmutation and appreciation. Courts should confine application of both the *Van Newkirk* rule and the active appreciation rule to the increase in value of separate property that occurs during the marriage; the rules should not be permitted to convert entire separate property to entire marital property. Such a result would run afoul of all three principles referenced above.

Endnotes

1 *Van Newkirk v. Van Newkirk*, 212 Neb. 730, 733 (1982).

2 *Id.*

3 *Coufal v. Coufal*, 291 Neb. 378, 383 (2015) (quoting 1 Brett R. Turner, Equitable Distribution of Property § 5:54 (3d ed. 2005) (updated Nov. 2016)) (internal quotation mark omitted).

4 *Van Newkirk*, 212 Neb. at 731.

5 *Id.*

6 *Id.*

7 *Id.* at 733-34. The Court did not disturb the trial court's finding that the value of the farm, as of 1963, should be set aside to the wife. It appears that the husband did contest this finding. Id. at 732.

8 *Id.* (emphases added).

9 *Id.*

10 *See* Sheila Bentzen, *What's Mine Is Yours . . . Sometimes: Solving the Puzzle of Nebraska's Approach to Allocation of Income and Appreciation of Separate Property*, 47 Creighton L. Rev. 37, 47 (2013) ("Practically, the passive nature of the appreciation [in

Van Newkirk] allowed the property to retain its nonmarital status; however, the court did not couch it in these terms.").

[11] *See, e.g., Tyler v. Tyler*, 253 Neb. 209, 213 (1997).

[12] *See, e.g., id.* at 320 (stating that "each time the *Van Newkirk* exception has been applied, this court has required evidence of the value of the contributions and evidence that the contributions were significant" and placing the burden on the non-titled spouse to provide such evidence); *Walker v. Walker*, 9 Neb. App. 834, 841 (2001) (holding that "[m]uch more in the way of direct contribution" to the separate property was required before non-titled spouse could avail herself of the rule set forth in Van Newkirk). *But see Plog v. Plog*, 20 Neb. App. 383, 400 (2012) (stating that requiring "proof of value of contributions is, frankly, unrealistic and inequitable in the present sort of case [involving a farming/ranching operation], beyond requiring proof that the [non-titled] spouse's contributions were substantial").

[13] *Applegate*, 219 Neb. at 535 (emphasis added).

[14] *Grace*, 221 Neb. at 699.

[15] *Id.* at 700-01.

[16] *Charron v. Charron*, 16 Neb. App. 724, 730 (2008).

[17] *See* Craig Dallon, *Reconsidering Property Division in Divorce Under Nebraska Law in Light of the ALI's Principles of the Law of Family Dissolution: Analysis and Recommendations*, 37 Creighton L. Rev. 1, 36-37 (2003).

[18] *Harrower v. Harrower*, 71 P.3d 854, 857-58 (Ala. 2003) (footnotes omitted).

[19] *See Van Newkirk*, 212 Neb. at 733-34.

[20] *See, e.g., Shald v. Shald*, 216 Neb. 897, 901-02 (1984) (classifying entirety of separate property as marital upon finding that the Van Newkirk rule applied); DaMoude v. DaMoude, 229 Neb. 851, 853-54 (1988) (same); Plog, 20 Neb. App. at 401.

[21] One could argue that the Nebraska Supreme Court "hint[ed] at the adoption of a passive-versus-active distinction" in *Rezac v. Rezac*, 221 Neb. 516 (1985). Bentzen, *supra* note x, at 57. There, the Court classified the appreciation of premarital stock as marital because active forces – reinvestment of income back into the company – rather than passive forces drove the increase in value. *Rezac*, 221 Neb. at 518.

[22] *See* Turner, *supra* note iii, at § 5:55 (noting, for example, that the rule "is presently followed by an overwhelming majority of dual classification equitable distribution jurisdictions").

[23] *Coufal*, 291 Neb. at 379.

[24] *Id.* at 384.

[25] *Id.* at 386.

[26] *See id.* at 383 (citing the active appreciation rule and framing the inquiry in terms of the extent to which the appreciation "was caused by the efforts of either spouse"); *id.* at 384 (referencing lack of effort "from either spouse").

[27] *See id.* at 384 (stating that, in the *Van Newkirk* cases, "some level of indirect or direct effort was required by the nontitled spouse – not just inflation or market forces – in order to include the increase in value in the marital estate").

[28] *Stanosheck*, 294 Neb. at 148-49 (citing Neb. Rev. Stat. § 42–366(8) (Reissue 2008)); *id.* at 150 (stating that *Coufal* applies to any kind of retirement account without explicitly commenting on Coufal's applicability to other contexts).

[29] *See id.* at 148-50.

[30] *See id.* at 150 ("After *Coufal*, investment earnings accrued during the marriage on the nonmarital portion of a retirement account may be classified as nonmarital where the party seeking the classification proves . . . the growth is due solely to inflation, market forces, or guaranteed rate rather than the direct or indirect effort, contribution, or fund management of either spouse.").

[31] *See* Turner, *supra* note iii, at App. A. Under a unitary property theory, property is either wholly marital or wholly separate.

[32] *Id.* at § 5:56.

[33] *Coufal*, 291 Neb. at 383 ("In order to determine what portion of [titled spouse's] retirement account is nonmarital property, we examine *to what extent* the appreciation in the separate premarital portion of the retirement account was caused by the efforts of either spouse." (emphasis added)).

[34] Turner, *supra* note iii, at § 5:56.

[35] *Price v. Price*, 69 N.Y. 8, 14, 16 (1986); *see also Nardini v. Nardini*, 414 N.W.2d 184, 192 (1987) (similar).

[36] *See* Turner, *supra* note iii, at App. A ("To hold that active appreciation can arise only from direct efforts is to discriminate unfairly against spouses who contribution to their marriage is noneconomic.").

[37] *See Harris v. Harris*, 261 Neb. 75, 84 (2001); *Davidson v. Davidson*, 254 Neb. 656, 662-63 (1998).

[38] Turner, *supra* note iii, at § 5:56.

[39] *Rezac*, 221 Neb. at 518 (emphases added).

[40] *Coufal*, 291 Neb. at 385.

[41] *In re Marriage of Lattig*, 318 N.W.2d 811, 815 (Iowa App. 1982).

[42] Appellant Br. at 14, *Stephens v. Stephens*, No. A-16-0431.

[43] *Id.* at 14-20.

[44] Appellee Br. at 14, *Stephens v. Stephens*, No. A-16-0431.

[45] *See Stephens v. Stephens*, No. 14-2689, Order, 8-14 (Apr. 4, 2016).