Barristers' Chambers

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Is an earning capacity a marital asset subject to the sharing principle?
Waggott v Waggott [2018] EWCA Civ 727

Introduction:

The higher courts have over recent years repeatedly emphasised the need for consistency in the application of the established principles of financial remedy distribution on divorce as suggested by both the appellate decisions of **White** and **Miller/McFarlane**. Such consistency of principle application undoubtedly assists settlement and results as the Court of Appeal acknowledged in less than 10% of all such financial cases going to a contested hearing.

In the present appeal, the very basis of approach to the issue of whether an earning capacity developed over the marital period should be subject to the sharing principle and whether the existing limitation to compensation in fact revealed a misunderstanding of the House of Lords guidance were challenged.

To these and to a number of other arguments of alleged unfairness in the current established approach to distribution as argued, Moylan LJ with The President and MacDonald LJ agreeing, reasoned the current approach remained fair. It is suggested that the reasoning applied is instructive to the working practitioner.

Facts:

H and W had cohabited since 1991. They married in 2000 and separated in 2012. There was one child born in 2004. Both parties were accountants, but following a move in 2001 from Manchester to London, W, save for a one-off period, did not work again.

Whilst the parties had agreed that their capital and pensions should be divided equally, there remained issues as to the extent to which W should receive maintenance. After a final hearing, W received £9.76m of capital value, including c £1.4m of H's post separation deferred remuneration and received H £7.8 m.

The judge found the W had an income need for herself of £175k pa against which he found she would derive c £60k pa in a net interest return (at 1.75%) from the free capital award and hence awarded her maintenance to meet this shortfall, finding she could not adjust without undue hardship to the termination of maintenance by reason of the differential which still would exist in the parties' comparative lifestyles.

Both parties appealed.

Issues:

W's case:

i) W argued that H's earning capacity was a matrimonial asset and thus subject to the sharing principle and in which whilst of 'the same job and the same character' she had a right to continue to share and that any opposite conclusion was discriminatory where such earning capacity had been a product referable to the marital endeavour.

ii) W argued it was unfair to expect W to use her capital award to mitigate her income needs when H would meet his from his continuing earnings without recourse in the same way to his capital return. Hence W sought her income needs to be fully met by a maintenance provision.

iii) W also argued in the above circumstances that the compensation principle entitled her to a share of the husband's earned income in cases where H had gained enhanced earnings which exceeded his needs. In particular, compensation was awardable not only where one spouse had suffered a financial disadvantage but also where comparatively one spouse had gained a financial advantage.

Accordingly, W's claim was to 35% of the H's net bonuses earned up to 2019 and payable until 2022 and maintenance of £190k pa for the parties' joint lives.

H's case:

i) H argued earning capacity is not an asset to which the sharing principle applied.

ii) the fact W was receiving c £9.7 million was by itself sufficient to draw the conclusion that W would have sufficient to adjust without undue hardship.

iii) on compensation: the judge had been correct to reject the contention W had suffered a financial disadvantage greater than the sum awarded to her by application of the sharing principle and therefore there could be no basis for a compensation award per se.

iv) H contended the judge had been wrong not to conclude W could adjust without undue hardship and, having made provision for ongoing maintenance, had not given due weight to the clean break principle ongoing maintenance

Appeal Decision:

Moylan LJ giving the lead judgment suggested that much of the appeal on behalf of W had treated the interpretation of case precedent as if it was akin to the interpretation of a statute. Instead in the decided cases the courts were giving guidance to the approach to be undertaken only.

In his review of the relevant authorities, Moylan LJ stated the following:-

- The courts exercise of its discretionary powers must not be discriminatory (Lord Nicholls said in *White v White* [2001] 1 AC 596, 605B/C);

- Not all foreseeable future financial differences constitute discrimination. As per Wilson LJ in K v L [2011] 1 WLR 306, 313C/D:-

  "What is outlawed is discrimination on the ground of superficial differences which, on analysis do not reflect substantive differences …".

- The contention that an earning capacity was subject to the sharing principle was to be rejected because:-

  a) Any extension of the sharing principle to post-separation earnings would fundamentally undermine the court's ability to effect a clean break – in effect, if permitted, the principle would apply to every case in which one party had earnings which were greater than the other's, regardless of need; a court would then need to assess the extent to which the earning capacity had accrued during the marriage, and so where would the court start and by reference to what factors would the court determine this issue.

  b) As **Charman** [2007] had stated the sharing principle applied to marital assets ie "the property of the parties generated during the marriage otherwise than by external donation" (para 66). An earning capacity was not property and, on the facts of the present case it would if applied as suggested result in the generation of 'property' after the marriage. Indeed, passages in **Miller** and **Scatcliffe** [2017] had suggested that an earning capacity was not to be regarded as a matrimonial asset and, albeit obiter, Wilson LJ had addressed this very issue in Jones v Jones [2011] as follows:-

  "A spouse's earning capacity will usually be a central foundation of an order for periodical payments, and thus of any order by way of capitalisation thereof, pursuant to the principles of *need* and/or of *compensation*. Even if, however, an earning capacity may also sometimes be relevant to a fair distribution of the assets pursuant to the *sharing* principle, it does not follow that the earning capacity should itself be treated as one of those assets, still less that an attempt should be made to capitalise it."

- The even 'more extreme argument' was also to be rejected that W's capital should be shielded and not used to meet her income needs. This was because:-

  a) Such a course would again conflict with the clean break principle so as to undermine the statutory "steer". Indeed, absent other resources, an applicant spouse would then always have a claim for an additional award to meet his or her income needs".

  b) Instead, the need principle is to be applied when determining whether the sharing award is sufficient to meet that party's future needs. The court is to retain its flexibility in approach and as Wilson LJ observed in **Jones** (para 27), an earning capacity can be "relevant to a fair distribution of the assets pursuant to the *sharing* principle". It can eg. be taken into account when the court is

deciding whether the capital should be amortised in full, in part or not at all and when deciding what assumed rate of return to apply

- In a case where an applicant spouse is required to use their sharing award to meet their income needs when the other spouse will meet their needs from earned income, then in determining what is fair the court will in each case where relevant take account of the earning spouse's greater utility of resources available when deciding the extent to which the applicant spouse should be called on to use their sharing award in that way. However, there can be no mandated approach.

- Again, as to 'an assumed rate of return' when considering the appropriate capital sum., Ryder LJ in **H v H** ***(Financial Remedies)*** [2014] EWCA Civ 1523 had rejected the notion of 'an industry standard' at 3.75% pa, but had expressly endorsed that Duxbury rate if acceptable on the facts of the case and it followed that as such Duxbury rate was a good starting point.

- As to the issue of compensation raised, Moylan LJ re-iterated that it is clear from **Miller's** decision "that compensation is for the disadvantage sustained by the party who has given up a career." Absent allegations of conduct, arguments as to what had happened in the past in determining if one party had been advantaged or disadvantaged by the actions of the other were likely to be sterile and should be avoided. Otherwise there were likely to be real evidential difficulties in measuring a financial advantage or disadvantage. Instead, the court should concentrate on the financial consequences of the relationship. In this case in any event the outcome of the sharing exercise provided W with more than any suggested compensatable loss and the court did not want to give any encouragement for any more extensive or expensive exploration of the issue. Where such an issue was relevant, as a necessary factual foundation the court would have to determine, on a balance of probabilities, that the applicant's career would have resulted in them having resources greater than those which they will be awarded by application of either the need principle or the sharing principle.

W's appeal was therefore rejected.

However, on the H's appeal, the Court agreed that the first instance judge, when determining that W could not adjust without undue hardship to a term order, had determined the matter too narrowly.

Indeed, the Court of Appeal considered that the matter should have been addressed more broadly including consideration of whether it would be fair for W to use part of her capital to meet her income needs – such a broader view was required to properly address the question of *undue hardship* under the statute and also so as to give proper weight to the clean break principle. Here W would still retain a large free capital award and it would be fair to expect her to use what had been estimated to be up to 21% of such free capital or 10% of the overall capital award to meet any future income shortfall.

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Accordingly, the Court of Appeal allowed the H's appeal to the extent of imposing a term order expiring in March 2021 with a section 28(1A) bar.

Ashley Murray Chambers, Liverpool.

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