

Future Earnings & Bonuses

Grey Areas and Unresolved arguments
post *Waggott*

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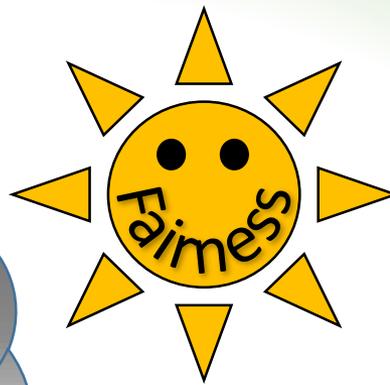
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June 2019

TANFIELD

Questions

- Which grey areas and unresolved arguments remain after ***Waggott***, on
 - future earning capacity as a matrimonial asset and
 - treatment of bonuses?



Needs

Compensation

25 Matters to which court is to have regard in deciding how to exercise its powers under ss. 23, 24, 24A, 24B and 24E.

(1)

It shall be the duty of the court in deciding whether to exercise its powers under section 23, 24, 24A, 24B or 24E above and, if so, in what manner, to have regard to all the circumstances of the case, first consideration being given to the welfare while a minor of any child of the family who has not attained the age of eighteen.

(2)

As regards the exercise of the powers of the court under section 23(1)(a), (b) or (c), 24, 24A, 24B or 24E above in relation to a party to the marriage, the court shall in particular have regard to the following matters—

- (a)** *the income, earning capacity, property and other financial resources which each of the parties to the marriage has or is likely to have in the foreseeable future, including in the case of earning capacity any increase in that capacity which it would in the opinion of the court be reasonable to expect a party to the marriage to take steps to acquire;*
- (b)** *the financial needs, obligations and responsibilities which each of the parties to the marriage has or is likely to have in the foreseeable future;*
- (c)** *the standard of living enjoyed by the family before the breakdown of the marriage;*
- (d)** *the age of each party to the marriage and the duration of the marriage;*
- (e)** *any physical or mental disability of either of the parties to the marriage;*
- (f)** *the contributions which each of the parties has made or is likely in the foreseeable future to make to the welfare of the family, including any contribution by looking after the home or caring for the family;*
- (g)** *the conduct of each of the parties, if that conduct is such that it would in the opinion of the court be inequitable to disregard it;*
- (h)** *in the case of proceedings for divorce or nullity of marriage, the value to each of the parties to the marriage of any benefit which, by reason of the dissolution or annulment of the marriage, that party will lose the chance of acquiring.*

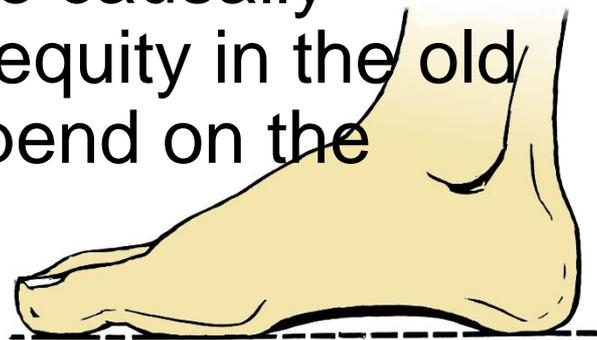
Waggott v Waggott - UKSC

- Supreme Court refused permission to appeal “because the application does not raise an arguable point of law” (31.1.2018 – Lords Wilson / Hodge / Briggs)
- Leaves us with Court of Appeal judgment

Digression – Needs: the Judge’s Foot

- Mostyn J, *FF v KF* [2017] EWHC 1093, §18:

“So far as the "needs" principle is concerned there is an almost unbounded discretion. The main rule is that, save in a situation of real hardship, the "needs" must be causally related to the marriage. Like equity in the old days, the result seems to depend on the length of the judge's foot”



A starter for 10: What are 'Needs'?

- Mostyn J, **FF v KF** [2017] EWHC 1093, §18 *commenting on McCartney, Juffali and AAZ v BBZ*:

“Plainly "needs" does not mean needs. It is a term of art. Obviously, no-one actually needs £25m, or £62m, or £224m for accommodation and sustenance. The main drivers in the discretionary exercise are the scale of the payer's wealth, the length of the marriage, the applicant's age and health, and the standard of living, although the latter factor cannot be allowed to dominate the exercise”

N.B. McCartney [2008] EWHC 401 (Fam), *Juffali* [2016] EWHC 1684 (Fam)) *AAZ v BBZ* [2016] EWHC 3234 (Fam)

Waggott v Waggott

Waggott v Waggott [2018] EWCA Civ 727

- Equal division of capital resources (agreed);
- W received £9.76 m.
- W's income need assessed at £175k pa, to be met by
- Joint lives Sp PPs less the £60k pa that W's own assets produced (at net rate of return of 1.75% pa).

Waggott v Waggott (2)

W appealed arguing: -

1. H's earning capacity built up during marriage = result of marital endeavour → SHARE, and
2. Why recourse to her own assets (w. investment return) to meet needs when H did not have to do so?
3. Compensation should apply – where a financial *advantage / benefit* (c.f. *disadvantage*) had accrued to a person by reason of marriage.

Waggott v Waggott (3)

H cross-appealed arguing: -

1. “Earning capacity” ≠ asset which can be shared, and
2. £9.7m = large enough award to justify effecting a clean break.
3. Compensation? H said W had not sustained a financial *disadvantage* greater than that which would be remedied by the sum given to her pursuant to the sharing principle. H argued for a 5 year term with a s 28 (1A) bar (on appeal).
4. 1.75% net = too *low* a notional return on W’s capital assets – shd be 2.5–3 % net

(J had ultimately adjusted rate from 1.75% net to 2.25% net at a further hearing following the judgment in ***H v H (Financial Remedies)*** [2014] EWCA Civ 1523

Waggott v Waggott - outcome

- Cannot have share in an earning capacity
- Needs-based award
- Yes W can have a notional rate of return applied to her capital assets
- Court determined that compensation could not apply to an advantage + W not *disadvantaged* on these facts
- Rate of return – start with Duxbury – 3.75% before 40% tax (applicable rate of tax on these facts)
- Yes to s 28(1A) bar and 5 year term
- Victory for H

Waggott v Waggott

- How did the Court of Appeal reach its decision?

Waggott v Waggott (4)

Sharing arguments. Court considered: -

1. **Miller / McFarlane** [2006] UKHL 24 arguments
2. **Charman No. 4** [2007] EWCA Civ 503
3. **McFarlane v McFarlane; Parlour v Parlour** [2005] Fam 171
4. **White v White** [2001] 1 AC 596
5. Ref also to **VB v JP** [2008] 1 FLR 742 (HC) § 59
6. **Hvorostovsky v Hvorostovsky** [2009] 2 FLR 1754 § 37
7. **H v H (Financial Remedies)** [2014] EWCA Civ 1523 at § 40
8. **Scatliffe v Scatliffe** [2017] AC 93 at § 25
9. Capitalising earning capacities: **Jones v Jones** [2012] Fam 1 (CA) esp at § 25 (b)
10. **B v S** [2012] 2 FLR 502 – § 79

Sharing post-separation earnings – Bonuses / Run-off

- Mr Dyer QC (for H) initially submitted: no reported case of application of sharing principle to post-separation earnings
- MacDonald J: that overlooks cases in wh spouse awarded a share of post-separation earnings *other than* by reference to needs or compensation (e.g. **H v H** [2007] 2 FLR 548 (see § 107, 134 – share of future bonus)
- Charles J said he was applying “fairness, equality and non-discrimination” (§ 134)... but also that
- Rationale “could be classified as either compensation or sharing” (§ 111, **H v H**)
- i.e. “Run-off” (per Charles J and Mr Dyer QC)
- Mr Dyer: often offered on pragmatic basis in order → agreed settlement
- (See discussion at § 61, 91 and 92 of **Waggott**)

Sharing post-separation earnings – Bonuses / Run-off (2)

- Bonus sharing cases, said EWCA in **Waggott** “could be said to support the proposition that the sharing principle applies to post-separation earnings” (§ 91)
- Tension with **Rossi v Rossi** [2007] 1 FLR 790: non-matrimonial bonus = relates to period wh >= 12m post-separation (§ 24 (4), **Rossi**)
- C.f. the 3 years in **H v H** [2007] 2 FLR 548
- Also in **CR v CR** [2008] 1 FLR 323 – Bodey J awarded additional capital sum to “reflect large imbalances of future earnings” (**Waggott**, § 92)

Waggott v Waggott - Compensation

- Compensation arguments, EWCA was referred to: -
 - ***Miller / McFarlane*** [2006] UKHL 24 arguments, esp. Lord Nicholls at § 13, 28, 32 and 93, and Lady Hale at
 - ***McFarlane v McFarlane*** [2009] 2 FLR 1322
 - EWCA struggled with quantification of this (***Waggott***, § 96), as had Charles J in ***McFarlane v McFarlane*** [2009] 2 FLR 1322 on the variation application.

Waggott v Waggott – Compensation (2)

- “was it being proposed that the court would have to seek to determine what each of the parties would have been earning if there had been no marriage and then calculate the quantum of, respectively, the advantage and the disadvantage? Otherwise, how was the advantage and/or the disadvantage to be determined?” (*Waggott* 96)
- “Hard to envisage” what evidence could → court to conclude
 - How a career would have developed absent marriage or
 - extent to which career enhanced by marriage (§ 96)
- Similar problems if court had to determine extent to which earning capacity = product of marital endeavour (building upon *Jones v Jones* [2011] 1 FLR 1723) - “significant evidential and conceptual difficulties” (*Waggott*, 98)
- For EWCA, clear from *Miller / McFarlane* that compensation could only refer to a **disadvantage** as opposed to an **advantage** (see *Waggott* 139).

Waggott v Waggott – Compensation (3)

- For a “compensation” argument to succeed court would have to determine that
 - the applicant’s career would have resulted in the applicant having resources “greater than those which they will be awarded by application of either the need principle or the sharing principle” (§ 139), and
 - it must also be *fair*.
- So compensation argument still possible (just), but denuded by **Waggott**....

Clean Break steer

- *Duty* of court under s 25A(1): -
 - “to consider whether it would be appropriate so to exercise those powers that the financial obligations of each party towards the other will be terminated as soon after the grant of the decree as the court considers just and reasonable”

Clean Break steer (2)

- Court shall give particular consideration under s 25A(2) to: -
 - “whether ..appropriate to require ...payments to be ...for such term as would”
 - “...be sufficient to enable [receiving] party ...to adjust without undue hardship to
 - the termination of ... financial dependence on the other ...”

Sharing Post-sep'n earnings v Clean Break

- “Any extension of the sharing principle to post-separation earnings would fundamentally undermine the court’s ability to effect a clean break” (**Waggott**, 123)
- In principle, entitlement to share would continue until payer ceased working (cd be many years)
- To effect a Clean Break would require capitalising it – conflicting with **Jones** (supra, at 27) – “costly artificiality” per Wilson LJ,
 - (who there referred to **Charman No. 4** comments re. “complexity and potential confusion” of sharing earning capacity to wh other spouse “contributed” (see § 67, **Charman No. 4** [2007] 1 FLR 1246))

Broad impact of “sharing” future earnings

- Application of sharing principle to earning capacity “would apply to every case in which one party had earnings which were greater than the other’s, regardless of need. This could well be a very significant number of cases” (***Waggott*** 124).
- That would not sit with Lady Hale’s observations in ***Miller / McFarlane***
 - “(i)n general”, “it can be assumed that the marital partnership does not stay alive for the purpose of sharing future resources unless this is justified by need or compensation” (§ 144) or
 - her observation as to the effect of “(t)oo strict an adherence to equal sharing” (§ 142).

Sharing future income: assessing accrual of earning capacity

- “it would inevitably require the court to assess the extent to which the earning capacity had accrued during the marriage.”
- “This would require the court to undertake the exercise to which there are the powerful objections referred to by Wilson LJ in ***Jones v Jones***.”
- “Where would the court start and by reference to what factors would the court determine this issue?” (§ 125)

Marital 'property' arguments

- Post- *Miller / McFarlane* [2006] UKHL 24 decisions, esp: -
 - *Scatliffe v Scatliffe* [2017] AC 93
 - *Jones v Jones* [2012] Fam 1, [2011] 1 FLR 1723
- Do not support extension of sharing principle to earning capacity;
- Sharing applies to: -“the property of the parties generated during the marriage otherwise than by external donation” (*Charman v Charman (No 4)*, § 66).
- An earning capacity \neq property and, “in the context advanced by [W here], it results in the generation of property *after* the marriage.” (§ 128)

Can W preserve her capital?

- “I reject [W’ counsel’s] more extreme argument that the wife’s capital, apart from her housing need, should be preserved and should not be used in any way to meet her income needs.”
- “This again would conflict with the clean break principle to such a significant extent as to undermine the statutory “steer” because,”
- “absent other resources, the applicant spouse would always have a claim for an additional award to meet his or her income needs.” (§ 130)

Chicken / egg Sharing / Needs

- “Lady Hale commented that there was no ‘hard and fast rule about whether one starts with equal sharing and departs if need and compensation supply a reason to do so, or whether one starts with need and compensation and shares the balance’ (*Miller* § 144).
- Lord Nicholls made similar comments (§ 28 and 29)
- Echoed in **Charman No. 4** at para 73 so
- “there must be a means of determining whether, and if so how, the sharing award does or does not meet the applicant’s needs. This inevitably also requires the court to determine in the individual case how the sharing award is to be deployed to meet needs.” (*Waggott* § 108)

Sharing, Needs & flexibility

- “it is clear from *Miller* and *Charman* alone that, as a matter of principle, the court applies the **need** principle when determining whether the **sharing** award is sufficient to meet that party’s **future needs**.”
- “To repeat what I have said above (para 108), there must be a means of determining whether, and if so how, the sharing award does or does not meet the applicant’s needs.”
- “Indeed, any other approach would be inconsistent with the observations made [in *Miller / McFarlane* ... and inconsistent with *Charman* ... in which the sufficiency of the award by reference to the sharing principle is directly assessed by the award ‘suggested by the needs principle’.” (*Waggott*, para 131)
- “This does not mean that the manner in which the need principle is applied to the sharing award is inflexible” (§ 132)
- Can be when 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”

Amortisation / Rates of Return

Flexibility in needs-based awards “has included as to the deployment of the applicant’s own capital and in respect of amortisation and rates of return” (§ 115):-

- **CR v CR** (§ 101, Bodey J applying 5% gross pa);
 - **B v B (Ancillary Relief: Post-Separation Income)** [2010] 2 FLR 1214 – 2% net pa;
 - **Z v A (Financial Remedy)** [2014] 2 FLR 109 – 3% net (§ 43 – 44);
 - **AR v AR (Inherited Wealth)** [2012] 2 FLR 1 (§ 100) – W was awarded a greater sum than that which would have resulted from a **Duxbury** calculation to give “an additional measure of security”.
 - **B v S (Financial Remedy: Marital Property Regime)** [2012] 2 FLR 502 at § 87 a non-amortised calculation was used (i.e. the capital was *preserved* not *reduced*).
- BUT, that said, in “a no. of other cases”, **Duxbury** (3.75%, amortised) e.g. **BD v FD (Financial Remedies: Needs)** [2017] 1 FLR 1420

Use of W's share of marital wealth

- “if, in some circumstances, a wife can be expected to meet her income needs out of inherited capital, it is difficult to see why the same should not apply to a wife’s share of marital wealth” [133]
- (approving Wilson (as LJ)) “it is ‘impossible to be categorical about what the law expects in this area’”.
- “range of options from full amortisation to an assumed rate of return +
- the range of potential circumstances (including all the section 25 factors) it is difficult to see how a definitive outcome can, in fairness, be mandated for all cases.
 - Some cases = clearly fair for that part of the sharing award available to meet income needs to be fully amortised, for example, because neither party has any resources other than those being shared.
 - Other cases, ...the applicant should [be given] a greater level of security than that provided by an amortised sum because of the respondent’s earnings and apply only an assumed rate of return.
- [So] the court will need to have regard to all the relevant circumstances, ...clean break principle and...issue of undue hardship.” (*Waggott* 134)

“Sharing” award meeting “Needs”

- “As to the specific issue raised in this case, namely
- whether it is fair for **an applicant spouse to be required to use their sharing award to meet their income needs** when the other spouse will **meet their needs from earned income,**
- the answer is that the **latter factor will be relevant to the court’s determination of the former issue.**” (*Waggott*, §138)

Duxbury?

- Duxbury model and the assumptions within it “clearly [have] advantages – both in terms of providing clarity and of consistency “ ...”at least as a starting point”.
- E.g. in *H v H* (*supra*) parties used 3.75% as an appropriate rate of return for the judge to apply
- “the manner by which the court assesses an award by application of the need principle and the manner by which it assesses whether a sharing award is sufficient to meet needs must be consistent.”
- “Given the consequential correlation between needs and sharing,
- “using the same model would remove a potential element of inconsistency between the two which might result in
- “different outcomes depending on whether the court started with a needs based award or vice-versa” (§ 136).

Shortfall of income

- In deciding whether to impose a term Sp PP order, J is criticised for *only* asking whether W could **earn** shortfall between income needs and amount her free capital generated = “too narrow”;
- “The judge should have addressed the issue more broadly including by considering whether it would be fair for the wife to deploy part of her capital to meet her income needs” (para 146).

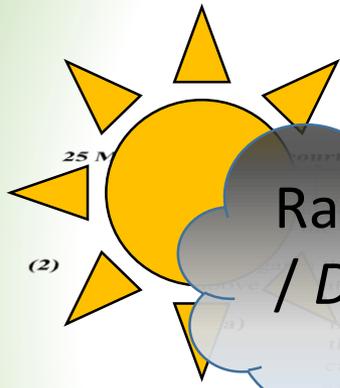
Shortfall of income (2)

- In this case, although not, I think, expressly articulated in the judgment, it is clear that the judge considered that the wife's income need would continue at this level for life.
- In any event, I do not consider that it would be appropriate for this court to determine this issue by reference to any lesser amount.
- The question, therefore, is **how would the wife be required to deploy her free capital in the absence of continuing periodical payments and, in the circumstances of this case, would it be fair for her to have to use it in this way.**

Waggott v Waggott - method

- Court applied 3.75% less 40% tax = 2.25% to W's own capital □
→ £100k pa.
- However, W can draw a pension from age 60, at which point she would need less income from H.
- Court used *Duxbury* to capitalise the c. £25k extra pa lifetime figure W would need (court thought that "*Duxburys*" at £360k (yetdoes it?)).
- H sought term expiring when W = 52, W short of £75k (i.e. £175k minus her £100k) for 8 years. $8 \times £75k = £600k$. Add on the £360k above and that is roughly £950k.
- H's appeal allowed: W could stomach that £950k from within her own £9.7m award - it being about 10% of that (apparently acknowledging that part of the £9.7m is pension).
- So H within the term would be paying £40k less pa, and benefitted from a term order! A resounding victory for H, it seems...but

Post-*Waggott* Forecast:



Rate of Return
/ *Duxbury*



Level of
Amortisation

- 25 N... court is to have regard... deciding how to exercise its powers under... whether to exercise its powers in relation to all the circumstances of the family who has not attained the age of 18.
- (2) The court under section 23(1)(a) shall have regard to the following factors:—
- (a) the income, earning capacity, property and other financial resources which each of the parties to the marriage has or is likely to have in the foreseeable future, including in the case of earning capacity any increase in that capacity which it would in the opinion of the court be reasonable for the party to the marriage to take steps to acquire;
 - (b) the financial needs, obligations and responsibilities which each of the parties to the marriage has or is likely to have in the foreseeable future;
 - (c) the standard of living enjoyed by the family before the breakdown of the marriage;
 - (d) the age of each party to the marriage and the duration of the marriage;
 - (e) any physical or mental disability of either of the parties to the marriage;
 - (f) the contributions which each of the parties to the marriage has made or is likely in the foreseeable future to make to the welfare of the family, including looking after the home and caring for the family;
 - (g) the conduct of each of the parties, if that conduct is such that it would in the opinion of the court be inequitable to disregard it;
 - (h) in the case of proceedings for divorce or nullity of marriage, the value to each of the parties to the marriage of any benefit which, by reason of the dissolution or annulment of the marriage, that party will lose the chance of acquiring.



Run-off



Compensation



Sharing
Income

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