KEYS TO THE KINGDOM

CALIFORNIA FAMILY LAW FINDINGS, ORDERS, AND PRACTICE POINTERS (2019 Edition)

BY

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PRACTICE POINTERS

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PRACTICE POINTERS—SETTLEMENT OF PROPERTY AND FINANCIAL ISSUES

In theory, virtually all financial and property issues should settle. Carefully evaluate the following sentence: If two rational parties had perfect information regarding the financial issues, and accurately evaluated the risks and benefits of litigation, they could virtually always agree on a settlement. This sentence contains at least three major assumptions: 1) the parties have complete and accurate information, 2) they are properly analyzing the risks and benefits of litigation, and 3) they are rational actors. Based on viewing thousands of family law litigants in court, a family law judge could be tempted to conclude that these assumptions are rarely true in the vast majority of cases.

That assumption is apparently wrong. In fact, in Los Angeles County as many as 98 percents of family law cases may settle. The vast majority of family law cases settle without the parties ever making any court appearance and seeing a judicial officer. Only about two percent of family law cases are resolved by trial. These statistics are a testament to the fact that the overwhelming majority of litigants rationally settle with no judicial involvement. The statistics also underscore that the family law litigants judicial officers see are a very select group of individuals who are clearly not representative of the total population of family law litigants, the vast majority of whom we never meet.

The three assumptions built into the statement that with complete information and a proper evaluation of the benefits and risks of litigation rational parties should almost always settle not only explains why almost all cases do settle, but it also holds the key to explaining why the tiny percentage of cases tried did not settle.

☐ FIRST, DO THE PARTIES HAVE COMPLETE AND ACCURATE INFORMATION?

☐ Have the parties exchanged offers?

The most basic reason for no settlement is a lack of knowledge regarding the other side's offer. This can occur simply because the parties are not communicating. Surprisingly, this occurs even when parties are represented by counsel. Some cases can be settled merely by asking the parties, "Have you exchanged offers?" It is hard to believe that such a simple technique would ever work. But it does!

☐ Have appropriate disclosures been made?

The family code contains a sue sponte duty to share complete and accurate information in dissolution cases. We have seen that one purpose of this policy is to promote settlement. (See findings and conclusions 6.1.) However, parties do not always have complete and accurate information. A settlement may also not have occurred simply because required documents, such as an income and expense declaration or preliminary declaration of disclosure, have not been provided. Perhaps the parties cannot agree on what to do with the family house or the family business because they don't know its value. They can't agree on how to divide the community debts because they don't know what debts existed at the time of separation. Therefore, the first step in any settlement is making sure the parties have communicated. Also, the settlement officer must determine whether information necessary to settle the case is available.

☐ Did the parties properly calculate the "delta"?

Another frequent problem that falls under the heading of complete information is whether the parties properly calculated the "delta." The delta is the dollar difference between both parties' respective reasonable best-case scenarios. They need to know how much money they are theoretically arguing over.

Again, it is surprising this is not always done. Suppose in a child support case, the father has a 97 percent time share of the parties' 17-year-old high school senior, who refuses to see her mother unless she is mad at her father. Father makes $5,000 a month. The mother has a three percent timeshare and also makes $5,000, so she must pay support. However, the mother argues that the father is underemployed and can earn twice as much—$10,000 month. She wants to go to trial on this issue. Both sides vow to hire vocational experts. This seems like a significant controversy, right? Wrong. Given only these facts, the difference between the two parties' positions is $136 a month. (This is based on a DissoMaster™ calculation). During the child's minority, over the course of 12 months, that is $1,632 ($136 x 12). The "delta" is $1,632.

☐ Did the parties properly calculate the cost of litigation?

Now the settlement officer and parties must also determine the cost of litigation. A decision maker must be armed with this basic fact before deciding between settlement and trial. Returning to the previous child support case, if the mother pays $350 an hour for an attorney for six hours to litigate this matter she will spend $2,100. Assuming a vocational examination and related testimony costs another $1,500 plus court-reporter fees ($382), she will pay a total of $3,982 for the chance of "winning" $1,632. Of course, if things don't go as expected, she may pay more. In a best-case scenario, she will lose $2,348 by litigating the matter. Father faces the same fate. The parties in this example would have to be virtually crazy to go to trial. The sad part is that this example is based on numerous actual cases.

☐ SECOND, DID THE PARTIES PROPERLY EVALUATE THE RISKS AND BENEFITS OF LITIGATION?

☐ Did the parties properly determine their reasonable best case scenario if the case is tried?

The parties must determine the potential reward from a trial. To do this, the parties must calculate their reasonable best-case scenarios (RBCS). People

will only settle a case if they determine it is in their best interests to do so. Often parties will complain that they don't like the proposed settlement because "it's not enough" or it's "too much." This misses the mark. The parties must be refocused on the real issue. The issue is not whether we like the settlement, but how the settlement compares with the only alternative to settlement—trial. To make this comparison we must determine both sides' RBCS. This concept is related to what in negotiation parlance is called the BATNA, which stands for the best alternative to negotiated agreement. Failing to understand the RBCS may result in rejecting a very good offer. The RBCS is calculated by taking the delta, the amount at stake in the controversy, and subtracting all costs that will result in the real world if the matter goes to trial.

A common scenario involves a dispute over real property, and also child and spousal support. The parties own a community rental property. Wife contends that the property is worth $500,000 and wants it confirmed to her so she can continue receiving the rents of $650 per month to support herself and the minor. Husband contends that the property is worth $550,000 and insists that it must be sold. Since both parties have plausible appraisals supporting their positions, either could prevail. If the husband is asked what his RBCS is he may respond, "Well, we're arguing over $50,000, so I stand to win $50,000 ... no, I guess it's half of that, $25,000." $25,000 is the delta. The property has a $450,000 mortgage. Therefore, the wife contends $50,000 in equity exists ($500,000 minus $450,000) and she must pay husband $25,000 to buy him out. Husband thinks there is twice as much equity—$100,000 ($550,000 minus $450,000). Therefore, he thinks the wife must pay him twice as much, $50,000 for the buyout. The husband says, "$25,000 is certainly worth fighting for."

But let's take a closer look at the husband's RBCS, which assumes that the judge rules in his favor and that the property really does sell for $550,000. We calculate this as follows:

First, we determine the net sales proceeds to be divided.

$100,000 (equity according to husband)
-$44,000 (estimated 8 percent brokerage and closing costs)

-$7,500 (estimated capital gain taxes in this hypothetical)
$48,500 CP value divided by two = $24,250

So the husband's share should be $24,250. This is already less than the wife's offer. The second step is to subtract the husband's litigation costs from this amount.

$24,250
-$5,600 (estimated attorneys' fees for 16 hours of work at $350)
-$1,500 (estimated expert fees for half day)
-$382 (court reporter fees)
= $16,768

The third step, which is almost always missed, is to determine the impact this ruling has on other parts of the case. One may wonder why so few people ever walk out of a family court after a trial satisfied. The judge invariably rules on some issues for one side and rules for the other party on others. No, this is not because the judge wanted to throw the other side a bone. There is actually a statistical and legal explanation. Family law disputes typically involve many issues. If you have a case with four major issues, and a 50 percent chance of winning each issue, the chance of winning all four is calculated like this: 50% x 50% (which is 25%) x 50% (which is 12.5%) x 50% (which is 6.25%). What we see is that the addition of each issue halves the chance of prevailing on all issues. If there were an excellent chance, an 80 percent chance, of winning each of the four issues, the chance of winning all four would be about 41 percent. The side with the excellent chance on all the issues has about a 60 percent chance they will lose one major issue. This assumes that all four issues are independent variables and that winning one makes it no more or less likely that you will win the other. But this is probably not true.

Some family law issues are positively correlated. For example, if a party prevails on their position regarding gross income available for child support, they are also likely to get a favorable ruling on spousal support. In other instances, a higher child support award will lead to a lower spousal support order. Many other family law issues are negatively correlated—winning issue

A makes it much less likely you will win issue B. Such is the case in our hypothetical. Remember, the wife wanted the property in order to generate $650 of income per month. If the husband "wins," the property will be sold and the wife will lose the $650 per month. This will hurt the husband when it comes time to calculate support and attorney's fees. The settlement officer, working with the attorneys, estimates that the husband should pay about $192 more per month in combined support as a result of his "win. Over the four-year life of the support order, this totals $9,216, which, reduced to its present value, could be about $6,452. Assume the settlement officer in this hypothesis predicts no adverse consequence to husband regarding need-based attorney's fees to wife. So after paying for litigation costs, the husband had $16,950. His RBCS is this:

$16,768
-$6,452 (additional support figure)
=$10,316

Therefore the husband stands to "win" $10,316 if everything goes his way. The wife is offering him $25,000, well over twice as much. As with the other fact patterns, this one is based on cases we see regularly.

Please note that the settlement's tax consequences, if any, must be calculated on an individual case-by-case basis and the parties may consult a tax professional.

The fourth step in determining the RBCS is calculating what you will actually receive after the judgment. Sometimes it's just the judgment—a piece of paper. Courts do not hand the winning side a suitcase full of money at the end of the trial. As they say, you can't get blood out of a turnip.

☐ Have the parties properly accounted for risk?

Risk aversion may be the most powerful psychological factor for people making financial decisions. Behavioral economists have shown that people respond much more strongly to avoiding risk than obtaining rewards. Attorneys and judges often explain the risk of litigation by using the saying, "A bird

in the hand is worth two in the bush." Adherence to this philosophy must be a key component in explaining the overwhelming number of settlements in criminal, civil and family law cases. In those few cases that do not settle, maybe the litigants have not properly evaluated the risks. Of course, it could also be that they have a very high-risk tolerance, such as the thousands of people who can be found on the gambling floors of Las Vegas casinos.

While risk aversion probably helps to explain the overwhelming number of settlements, it may also explain the delay in settling. While cases settle, the typical cases going through settlement court in Los Angeles County are at least two years old. Many are much older. Why does it take someone so long to decide to settle their case? Because of fear. Making a decision itself involves risk—the risk of making a mistake. The coping mechanism is to delay deciding. Behavioral economists call this phenomenon "decision paralysis."

Fortunately, we have a cure for decision paralysis. If the parties are afraid to make their own decisions, the judge will make all of the decisions for them. We call this a trial. Also, studies show that presenting people with many choices decreases their ability and willingness to decide. This is why we focus litigants on the fact that they really only have two choices—trial or settlement. This also explains why it is inadvisable for the settlement officer or attorney to confront litigants with too many options at once. The practice pointers dealing with negotiable aspects of various issues, such as child support, etc., caution against giving over two options at once. This improves the chance that litigants will understand, process, and make a rational decision. If litigants reject the suggested option, then another option can be suggested, and so on.

But the most effective antidote to decision paralysis short of a trial is a trial date. As an old adage goes, nothing focuses a man's mind more than hanging in the morning or a trial in the afternoon. The person with decision paralysis favors delay. A deadline—a trial date—may be the answer.

It is also possible that the parties have not properly factored the risk they are facing into their settlement offers. Consider a typical dispute regarding the community interest in the husband's separate-property business. A joint forensic accountant, applying the *Van Camp* analysis (see findings and con-

clusions 5.12), concludes that the community value is $100,000. However, applying the *Pierera* method, the community value is $1,000,000. The accountant states he strongly favors the *Pierera* method, which leads to the $1,000,000 result, because the business growth was largely, but not entirely, due to the husband's skill and efforts. The husband offers to pay the wife $50,000 for the business. The wife demands $500,000. Neither party's offer takes into account any risk that the judge will rule against them, nor do they factor in the cost of litigation.

In cases like these, especially if a large gap exists between the parties' respective offers, it is better for the parties to agree on general principles before discussing specific numbers. First, they should agree on what their respective RBCS include, and all expected trial costs. They should also agree that risk has to be accounted for in determining the appropriate settlement. To do this, the parties should agree that the offers have to be "risk adjusted." Working with the attorneys, the settlement officer can arrive at a risk adjustment multiplier. The delta is $450,000 ($500,000 - $50,000). In this hypothetical, after a detailed discussion, the settlement officer agrees with the accountant's assessment regarding which approach to use. The settlement officer calculates a 75 percent chance that the wife's position will prevail. Ideally, the settlement officer and both attorneys will agree on this multiplier. This means that the risk-adjusted settlement figure should be $450,000 (the delta) x .75 (the risk multiplier) + $50,000 (husband's position) = $387,500.

☐ Are the parties miscalculating the risk because of overconfidence?

People's own biases dictate their perceptions—a point so obvious it is almost not worth mentioning. Parties are likely to be highly overconfident regarding their case. The most able trial attorneys are capable of objectivity. They understand that their effectiveness depends on their ability to see weaknesses in their own case and strengths in the opponent's case. You cannot plug the holes in your argument if you never recognize them. However, studies show that, as a group, litigators are also overconfident regarding case outcomes. I have found that forensic accountants, even those who sometimes

take rather partisan positions favoring their clients, do an excellent job in rationally assessing cases during settlement discussions. When finances permit, forensic accountants should be involved in the settlement process. The most effective attorneys are always on guard against overconfidence and will analyze the case from the other side's perspective. The most effective means of addressing overconfidence is through using a neutral.

☐ ARE THE PARTIES PROCEEDING RATIONALLY?

Based on the very select group of persons a family law judge sees everyday, the answer to this question would often appear to be "no." There are many explanations why otherwise intelligent and rational individuals don't make financial decisions rationally. By identifying the causes of an irrational position the settlement officer may be able to promote settlement.

☐ Do the parties' stated positions match their stated goals?

Other checklists in this work emphasize the importance of determining the parties' stated goals. Often parties engage in "positional" bargaining. For example, "I will offer $2,000 in child support is countered by "I will accept no less than $4,000 in child support." The settlement officer might be tempted to throw up their hands and conclude that the parties are too far apart and the matter cannot be settled.

However, merely knowing the positions of the parties does not explain the reasoning behind those positions.

The settlement officer might ask "Why do you want no less than $4,000 in child support?" and "How did you figure out that you should pay $2,000 in child support?" What if the answer to the question about why a person wants $4,000 in child support is "Jane is 16 years old, and I need to save money for college now." What if the support payor says, "I know, my daughter needs money for college and I would love to help her, but I don't want to pay a dime more than I have to because the other party will blow the money." Now the settlement officer has a basis for settlement: Would the payor be willing to pay $2,000 a month in support plus make another $2,000 contribution to a joint college savings plan?

This solution would match the stated goals of both parties. It is not essential that the parties disclose their true goals as opposed to their stated goals. In other words, the support recipient may secretly want more money to spend on themselves and the payor may want to pay as little as possible out of anger towards the other parent. Once the stated goals are known, the settlement officer may "lock the parties in." "So, let me see if I understand you. You want to have a significant amount of money each month to save for college, right? About how much? Now I understand your goals and concerns. So will you settle if I can get the other side to agree to something that will match your goal? So if I can get the other side to agree to a solution that will give you enough money to meet your child's everyday needs, plus a reasonable amount to save for college, you will agree to it? I don't want to waste anyone's time, so are you sure about this?"

☐ Do the stated goals make sense and can they be changed?

Every once in a while a party will disclose their true but irrational or inappropriate goals. For example, they may say, "I want to have more time with my kid to make my support payment go down." It is surprising, but people do make comments such as this one. There are a couple of appropriate responses to the comment in this example. First, the court might gently point out the inappropriateness of the comment: "Shouldn't the custody orders be in the child's best interest?" Second, the settlement officer might gently point out the irrationally of the comment: "So let's see, if you get the extra 10 percent timeshare you are asking for that will save you $150 a month. Until your child is an adult that is roughly $4,500 over the next three years. So you want to spend about $20,000 on attorney's fees today to save about $4,500 over the next three years? Doesn't it make more sense to come up with a solution that will save you as much money overall as we can? Would you be willing to agree to pay more support than you think you should if you knew that in fact, it would save you lots of money overall?"

☐ Are the parties properly valuing the property and are psychological factors influencing their valuations?

There are several psychological factors that influence and explain how litigants attach irrational values to property. Behavioral economists have identified a psychological phenomenon known as the "endowment effect." We see the phenomenon on a routine basis in family court. To understand the effect, consider these hypotheticals:

You purchase a flat screen television for $1,000. It's in perfect working order. Six months later a neighbor sees your flat screen and says, "I'll buy it from you for $900, which is 10 percent less than the purchase price, plus I'll pay any costs associated to install a replacement TV." The chances are you would reject this offer. If you accepted the offer you would have to buy a new television for $1,000 and you would lose $100 in the process. Plus, the whole deal would be a hassle.

Now suppose you are visiting your neighbor and see his six-month-old flat screen. It's in perfect working order. You are in the market to buy this precise model. You know they retail for $1,000. Your neighbor says, "I really want a larger model. I'll sell this one to you for $900, which is a 10 percent discount, $100." You would probably reject this offer. You would figure that a much steeper discount should apply to a used six-month-old electronic item. It would be worth more than $100 extra to buy a new one. You would expect a one- third discount to purchase the used item.

What these two hypotheticals illustrate is that your subjective value of the television depends on whether you are the seller or the buyer. When you are the hypothetical owner, you value the television at more than $900. When you are the hypothetical buyer, you value it at about $666. If you own the property, the property has a more subjective value to you—the endowment effect. Of course, the market value is always the same—the price at which a willing buyer and seller would agree. The televisions' market value in the two hypotheticals is exactly the same.

The psychological tendency to overvalue property we own is well documented in the literature and routinely witnessed in court. Family law judges routinely hear people valuing the Ikea dining set they purchased five years ago for $5,000 to have a present value of $4,000. Since the judge knows that the

five-year-old Ikea dining set could not have retained 80 percent of its original purchase price, and since this seems plainly obvious, the judge may suspect that the party is stretching the truth regarding the set's value. In fact, the party may be honestly expressing their subjective valuation of the set consistent with the endowment effect.

A much more pernicious example of the endowment effect, in settlement discussions, involves the valuation of the marital residence. Disposition of the marital residence is often the key stumbling block to a financial settlement. The person occupying the house is likely to overvalue it and resist selling it at a reasonable price. If you have ever wondered why the party in the house often seems to think it's worth more than the party who is out of the house, you have a your answer. This can, and often does, lead to disastrous consequences when a home with little or no equity, and with a large mortgage payment, is maintained long after it should have been sold. It can also cause the home's occupant to make unreasonably large concessions in order to keep the house, even when their attorney and the settlement officer advise them not to do so.

How can the settlement officer cope with the endowment effect? One answer is to explain the concept of market value. Since judges intuitively recognize the endowment effect, they are already probably coping with it. For example, let's return to the valuation of the five-year-old Ikea dining set purchased for $5,000. A party tells the judge it's currently worth $4,000. The judge is likely to respond: "When we value such items, we use what's known as 'garage sale' values." This is not a bad effort to explain market value. However, the answer to how much it would sell for in a garage sale depends on who is selling it. If the owner, this party, were selling it in a garage sale they would sell it for no less than $4,000, because that is its subjective value to them. Suppose the party were asked: "Imagine the dining set got destroyed and the next day you see a five-year-old set identical to yours in every way at a garage sale. How much would you pay for it? How much would a typical person *pay* for your set?" The owner of personal property, if honest, will often tell you they would be willing to *sell* their property at a relatively higher price, but would only *purchase* that same property at a

lower price. They should understand that market price is not how valuable the property is to them.

Another part of the problem is that the term "value" is itself ambiguous. This point is often overlooked by family law lawyers and judges. When we use the term "value" we automatically assume that everyone understands that we mean "market value." This is because family law courts almost always use market value in resolving property disputes, with the notable exception of valuing professional practice goodwill. However, there are other types of value, such as "replacement cost." A litigant simply may not understand that when we are asking them about "value" we usually mean market value.

Also, be aware that property, particularly the family residence, some personal property, the family business, and pets may hold powerful emotional values to the parties. This is how a couple can spend $70,000 combined litigating over the possession of the family dog. The settlement officer will become aware of emotional values while talking to the parties. There is no point in denying people's feelings. The settlement officer may explain, "I understand how you feel about your home. You put a lot of work into it. You had lots of good times there. I understand and sympathize with you. Unfortunately, under the law of California, those types of emotional values don't determine the market value of the house. We have to look at the market value."

☐ Is anchoring preventing a reasonable settlement?

Anchoring is the strong phenomenon in which a party's financial decision-making process becomes heavily influenced by the first number they hear, an anchor. The number may serve as an anchor, even though it has no rational basis. The first offer may provide a strong psychological anchor that greatly influences the following negotiations. Imagine a case involving a self-represented litigant against a represented litigant. The self-represented litigant is asked, "So how much spousal support are you seeking?" After several evasive answers, he replies, "Let's see, well, I'm making $2,000 a month, and my wife is making $12,000 a month, and that's $10,000 more than I, so I guess I'm asking for $5,000. Yes, that's it, $5,000." An experienced family law

judge or attorney can immediately see this offer is based on faulty logic and is wildly unrealistic. A more realistic number might be $2,650 (unless some dramatic additional fact not contained in this hypothetical is revealed). When the settlement officer suggests that the husband reduce his offer to $3,000, he protests, "I can't do that; that's a 40 percent reduction!" This seems irrational, but again, the illustration is based on many actual experiences.

The settlement officer's interest is ensuring that any settlement is reasonable and fair. Therefore, the settlement officer should avoid allowing litigants to start negotiating with an unreasonable anchor. This is why settlement discussions should begin with a somewhat detailed discussion of the facts and legal issues so the settlement officer can assist attorneys and litigants in formulating offers based on expected results. If inappropriate anchors have already been dropped, the settlement officer might turn the conversation away from specific offers and amounts, toward a discussion of general goals, interests, and applicable legal and factual issues.

☐ Is emotion clouding the parties' decision-making?

Last, but certainly not least, emotions play a leading role in explaining why some family law matters take so long to settle. Family law matters are probably the most emotional types of cases. There is no point in denying people's emotions. "You shouldn't feel so angry," may not be effective advice. Sometimes it is necessary to allow some venting. It may also be advisable to do this venting outside the other side's presence. The mediator or attorney should use active listening techniques, such as, "What you are telling me is that you feel hurt and betrayed by your spouse's infidelity." But the mediator or attorney must move the party past these emotions. "I perfectly understand how you feel. We are here today to move forward. Are you ready to move forward today?"

As illustrated in this article, the entire focus of the settlement process regarding financial issues is to make what I call a "business decision." "Today we are talking about money. That's all we're talking about. I am asking you to make a business decision. Can you do that?" When the answer is "yes," we are well on our way to a rational settlement.

USE NOTES

Use the checkboxes to make sure the basic requirements for settlement have been met.

SOURCES AND AUTHORITY

The concepts discussed here as applied to family law matters are based on the author's experience. For a detailed discussion of settlement in family law matters see Folberg, Milne, and Salem, Divorce and Family Law Mediation (2004). For a compact overview of negotiation strategies see Luecke, Harvard Business Essentials—Negotiation (2003) and Fisher, Ury and Patton, Getting to Yes (1991). For an easy-to-understand work on behavioral economics, see Belsky and Gilovich, Why Smart People Make Big Money Mistakes (1999).