

**FEBRUARY 1997 CALIFORNIA BAR EXAMINATION
ESSAY QUESTIONS AND SELECTED ANSWERS**

Community Property

QUESTION

In 1974, Hugh (H), a resident of Iowa, a non-community property state, began working there for Apex. Apex has an employee retirement plan which gives to each employee who retires after 20 years of continuous employment with the company the option of receiving either a lifetime monthly pension payment or an actuarially equivalent single lump sum payment. H eventually retired from Apex in 1994.

In 1977, H obtained a credit card which carried with it, free of extra charge, a \$200,000 travel accident life insurance benefit on each commercial aviation flight ticket purchased with the credit card. The annual charge for the credit card was paid each year by H from his Apex salary and, after his retirement in 1994, from wages of a part-time job he held.

In 1983, H married Wendy (W) in Iowa, and H and W went to California on their honeymoon. While there, they visited a television studio where W appeared on a quiz show and won a condominium in California worth \$100,000. W took title to the condominium in her name alone. After their return to Iowa, H and W decided to move to California and live in the condominium. Apex had offices in California, and H arranged to be transferred there. H and W moved into the condominium in 1984.

In 1990, H received a sizeable bonus from Apex in recognition of his extraordinary work for the firm in 1989. Unknown to W, H used the bonus as a down payment on the purchase of an office building in California, taking title in his name alone. In November 1994, he sold the building for a small profit to a purchaser who paid full value and who was aware that H was married. The building has since increased substantially in value because of the announcement of the construction of a new shopping center nearby.

When H retired from Apex in 1994, he chose the lump sum payment option available under his retirement plan and received \$200,000 in cash which he used to buy U.S. Savings Bonds. He had the bonds registered, "H, Pay on Death to George." Under the applicable federal statute, such designation means that H is owner of the bond, but it is "payable on death" of H to George (G), who is H's brother.

In January 1995, H was killed on a flight to visit G. The credit card company's insurance carrier paid \$200,000 to H's estate. H's will confirmed to W her interest in their community and quasi-community property and gave all property over which he had power of testamentary disposition to G.

What are the rights of W and G to each of the following properties?

1. The condominium? Discuss.
2. The office building? Discuss.
3. The bonds? Discuss.
4. The life insurance proceeds? Discuss.

Answer according to California law.

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ANSWER A

California is a community property state. Property acquired during marriage is presumptively community property (CP). However, property acquired before marriage, or after permanent separation, is normally separate property (SP), as is property received by gift, bequest, or devise, as well as income, rental and profits from SP.

Quasi-community property (QCP) is property acquired by a married couple in a non-community property state (e.g., Iowa) which would have been CP had the couple been domiciled in California. At death, the QCP share attributable to the deceased spouse is treated as CP. The QCP attributable to the surviving spouse becomes her SP.

At death, a surviving spouse retains her separate property, any QCP attributable to her, ½ of the CP, and ½ of any QCP attributable to the deceased spouse. The deceased spouse can dispose of any remaining property by will.

We can now turn to analyzing specific assets with these general principles in mind.

1. The Condominium

Assets can be categorized by tracing funds to determine if they are SP, CP, or QCP funds. The source of funds for the condominium was game show winnings by Wendy (W). Although at the time, Hugh (H) and W were domiciled in Iowa, this property would have been CP had they been domiciled in California since they were married at the time and winnings are considered earnings insofar as their categorization as CP.

Accordingly, the condominium is QCP attributable to W. At death, QCP attributable to the surviving spouse becomes her SP. Therefore, W is entitled to the condominium - George will not receive a share.

2. The Office Building

The funds used to purchase the office building can be traced to H's 1990 bonus from work performed in 1989. A court would most likely consider this bonus CP because it represents earnings for work performed during marriage (and while living in California).

As CP funds were used, the office building represented CP to the extent of the down payment. For the rest of the building, it is unclear what the CP interest is. By implication, H received credit from a lender for the balance of the purchase price. The intent of the lender test is used to determine whether credit is CP or SP. If the credit was based on H's earning power it is CP. If the lender intended solely to look to H's SP, the credit is SP.

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When H sold the property in 1994, he disposed of real estate owned, at least to some extent, as CP. To be valid, W had to join in the sale in writing. Since the purchaser had notice of H and W's marriage he is not a bona fide purchaser. W is entitled to set aside the sale (by refunding the purchase price), which she will wish to do due to the substantial increase in price.

The building's ownership will then be split between W and G in proportion to the SP and CP shares. One-half the CP interest belongs to W (both through entitlement and under H's will). The remaining one-half interest, as well as any SP interest attributable to SP credit, will go to G. The court would use an analysis if payments were made by the community. Under the facts as given, this is unnecessary.

3. The bonds

The funds used to purchase the U.S. Savings bonds are traceable to \$200,00 paid to H as the lump sum equivalent of his retirement plan. His retirement represents deferred compensation for work performed for Apex both before and during marriage. The time rule is used to apportion the CP and SP interests:

(a) $\frac{9 \text{ years prior to marriage}}{20 \text{ years work at apex}} \times \$200\text{K} = \$90,000 \text{ SP}$

(b) $\frac{11 \text{ years married}}{20 \text{ years work at apex}} \times 200\text{K} = \$110,000 \text{ CP}$

Therefore, the savings bonds are part CP and part SP in the proportions shown. H has registered his bonds as payable to his brother G on death. This introduces the issue of federal preemption which prevents U.S. Savings Bonds from being subject to California CP law: title of the bond controls. However, an exception exists where a deceased spouse has used a payable on death clause to wrongfully misappropriate the surviving spouse's CP share of the bond. If this exception applies, W would be entitled to one-half the CP interest (\$55K) and G would receive the rest (\$145K). If the exception does not apply, G is entitled to \$200K.

4. Life Insurance Proceeds

The \$200K life insurance proceeds can be traced to a credit card fee paid from part-time wages earned during marriage. G might argue that since the credit card was obtained prior to marriage, any associate insurance proceeds are SP. Alternatively, G might argue that CP is entitled only to a time-rule apportioned share of the proceeds based on the number of annual fees paid during marriage in ratio to all annual fees paid over the life of the card. However, the more reasonable approach is to find that the life insurance proceeds are characterized by the most recent payment received in the form of an annual fee (by loose analogy to term life insurance).

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Since the flight insurance does not increase in value over time or represent a continuing investment, apportionment using the time rule is not indicated.

CP life insurance proceeds have apparently been channeled into H's estate as opposed to a named beneficiary. W is entitled to one-half (\$100K) and G is entitled to one-half (\$100K).

ANSWER B

California Community Property Law

California is a community property state. Once a couple enter into a valid marriage and are domiciled in California, California community property law governs their property. Under California law, any property acquired through labor during the marital economic community's existence is community property (CP). Any property acquired before marriage, or acquired during marriage as a gift, bequeath or inheritance, or rent or income on such property, is separate property (SP).

Quasi-Community Property. (QCP) is properly acquired by a married person who is domiciled outside of CA if that property would be CP if the couple were domiciled in CA. Once one of the spouses becomes domiciled in CA, CA rules on QCP apply.

Distribution at Death. At death, a spouse who dies has testamentary control over all her SP and over half of the CP. A surviving spouse retains her half interest in the CP. As for QCP, a surviving spouse is entitled to half of the QCP titled in the deceased spouse's name, and the deceased spouse has no testamentary power of the QCP titled in the surviving spouse's name.

Hugh and Wendy

Hugh (H) and Wendy (W) married in Iowa in 1983, where they appear to have been domiciled; they moved to California in 1984. Therefore, any property they acquired from 1983 to 1984 that would have been CP under CA law is QCP. After they became domiciled in CA in 1984, CA CP rules apply.

I. Condominium

A. QCP

The condo was acquired in 1983, after the marital economic community began. W acquired the condo through her labor of participating in the quiz show. Thus, if H and W had been domiciled in CA at the time, the condo would have been CP. Since they were domiciled in Iowa, the condo is QCP.

B. Married Woman's Special Presumption (MWSP)

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Before 1975, title in the name of a married woman alone carried the presumption that the property was her SP. Since W acquired the condo in 1983, the MWSP does not apply.

C. Distribution at Death: W and G's rights

W is entitled to 100% ownership of the condo. The condo is QCP and is titled in W's name. Therefore, H had no testamentary power over the condo, and could not pass any interest in it by will to George (G). If, however, a court were to hold that the condo was CP because it was CA Real Property, then H would have testamentary power over his half interest in the condo as CP and could pass that interest to G.

II. Office Building

A. When and How Acquired

H bought the office building after 1990, so it was purchased during the marriage and while H and W were domiciled in CA. H purchased the building with his bonus. H's bonus was received in 1990 and was designed as compensation for labor he put forth in 1989 - in other words, for marital labor. Therefore the bonus was CP. Because the office building was purchased with the bonus, the office is also CP, since a change in form does not change the character of the property.

B. Title in H's name

H took title on the building in his name alone. This alone, however, does not transmute the CP bonus into a SP office building. Since 1985, gifts of CP have required written agreement by the party whose interest is affected. Since W did not know of H's actions, she cannot have consented to them in writing, and therefore H's taking title in his own name did not convert the CP into SP.

C. Nov. 1994 Sale

H sold the office, which was CP, without W's necessary consent. This violated H's duties of management and control. Although the buyer paid value, she was aware that H and W were married.

Because a sale of CP Real Property requires written consent of both spouses, a spouse who does not consent can void the sale if the spouse acts to void the sale within one year. Here, the purchase was in Nov. 1994 and H has died in Jan. 1995. If less than a year has passed since the sale, W can void the sale, though she will have to return the purchase price. She will not, however, have to return the subsequent appreciation.

D. Distribution: W and G's Rights

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Because the office was CP, W already owns a half interest if she can recover the property. If she does recover the property, G may be entitled to a half interest, since H had testamentary power over half the building as CP. However, since H violated his fiduciary duties to the community by taking title in his own name and selling the CP without consent, a court might refuse to uphold a distribution by will of the share after W recovers the property.

III. Savings Bonds

A. When and How Acquired

H bought the bonds in 1994, while married and domiciled in CA. H used his retirement pay to buy the bonds.

B. Characterization of Retirement Pay

H's retirement pay is SP to the extent earned with his SP labor and CP to the extent earned with his CP labor. The time rule is used to apportion the ownership. H worked for twenty years to earn the pension. Ten years he was single, and ten years he was married. So $\frac{1}{2}$ of the lump sum is H's SP and $\frac{1}{2}$ of the lump sum is CP (\$100,000).

C. Purchase of Bond and Preemption

U.S. Savings Bonds are ordinarily preempted from CP law. Therefore, the \$100,000 that was CP and invested in the bonds would ordinarily be preempted from distribution under CA CP law. However W may be able to show that H's purchase of the bonds was fraud, since it does not appear that she was aware of or consented to H's purchase. If so, W should be able to establish that CA CP law should not be preempted as to the CP share of the Bonds - \$100,000.

D. Distribution

If CA CP law is not preempted as to the CP share of the bonds, W will be entitled to $\frac{1}{2}$ of that share, or \$50,000 plus $\frac{1}{4}$ of the appreciation. G will be entitled to \$150,000 plus $\frac{3}{4}$ of appreciation representing H's \$100,000 SP share and the $\frac{1}{2}$ CP share over which H had testamentary control.

IV. Life Insurance

A. When and How Purchased

The insurance was probably "purchased" when H paid the credit card annual fee. This was while married and domiciled in CA. H paid with marital wages from his part-time job, which are CP. Therefore, the policy is CP.

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B. Distribution: W and G' Rights

Because the premium was paid with CP, the benefit is also CP. W is therefore entitled to half of the benefit, or \$100,000, as her share of the CP. G is entitled to the other half of the benefit, or \$100,000, as the half of the CP over which H had testamentary power.

C. Alternatives

It might be found that the policy was “purchased” when H opened the account - in Iowa, before the marriage. However, he still paid the annual fee with marital earnings. Therefore, a court might consider the insurance paid with both CP and SP.

As term life insurance a split of authority exists as to how to handle the benefit. Some courts look only to the last payment - in this case, from CP. Other courts apportion the payments. In that case, G would be entitled to ½ the CP share (over which H had testamentary control) and to all of the SP share.