JULY 1998 CALIFORNIA BAR EXAMINATION
ESSAY QUESTIONS AND SELECTED ANSWERS

Community Property

QUESTION

Winnie and Herb married in State X in 1990. Prior to their marriage, Winnie had been a lifelong resident of State X and Herb had been a lifelong resident of State Y. Neither State X nor State Y is a community property jurisdiction. Winnie and Herb moved to California in 1993.

Winnie continued to be active in managing her own substantial brokerage account which she had acquired with her savings prior to her marriage. Winnie did not move the account from State X after moving to California with Herb. On most business days, she directs her stockbroker in State X to buy and sell particular stocks. Winnie has been very successful as an investor. At her direction, all income from the investments has been automatically reinvested. The brokerage account has greatly increased in value during the period of her marriage because of both the reinvested income and the appreciation in the value of the underlying securities.

Shortly before their marriage, Herb had taken early retirement from his company because of a heart condition and began receiving his pension in the form of a monthly payment of $3,000 for life. All of Herb's monthly pension payment is needed to pay Herb's and Winnie's living expenses. Herb has been unable to pay the full amount of his uninsured, but necessary, medical expenses.

By 1997, Herb's unpaid medical expenses had mounted, and Herb's creditors began to take steps to obtain payment. At the same tune, Herb's former wife Fran sued Herb in State Y for child support. Fran won a judgment for back child support and for on-going child support that requires Herb to pay the college tuition and expenses for his nineteen year old son, Sam, until Sam turns twenty-one.

Herb's medical expense creditors and Fran are trying to recover their respective claims from Winnie's brokerage account in State X.

The strain on the marriage caused by these financial problems resulted in Winnie moving away from Herb and filing for dissolution of the marriage. Herb's medical debts continued to mount after their separation.

1. May Fran enforce the judgment for child support against Winnie's brokerage account? Discuss.

2. May Herb's medical expense creditors recover their claims from Winnie's brokerage account? Discuss.

3. What interest, if any, does Winnie have in Herb's pension? Discuss.

Answer according to California law.

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Community Property

ANSWER A

California is a community property state. All earnings during marriage are presumed to be community property (CP). All earnings before marriage and after separation are presumed to be separate property (SP). A court will determine the character of assets by examining when and how they were acquired, and the effect of the parties' actions and legal presumptions on the assets.

Quasi - Community Property

Property that is acquired in a non-CP state that would have been CP if acquired while the parties were domiciled in CA is considered quasi-CP. The property retains its SP character during marriage (except as to creditors), but is treated as CP at divorce.

With these presumptions in mind, we must examine each of the assets and liabilities at issue.

Winnie's Brokerage Account

Property acquired before marriage is presumptively SP. Winnie began her brokerage account before her marriage to Herb, with her own savings. Thus, it is presumptively SP, and its character does not change when the parties moved to California.

However, the brokerage account grew in value during the marriage, due in part to Winnie's management of the account. Thus, at least some of the earnings in the account are the result of marital labor, and thus are presumptively CP.

When marital labor (CP) contributes to one spouse's SP, increasing its value, courts must decide what percentage of the asset remains SP, and what should be treated as CP. The court will use one of the two methods used in the cases of Van Camp and Pereira.

Van Camp should be used when an SP asset has been substantially improved because of the nature of the underlying asset, rather than because of the personal contribution of the spouse. Where this is the case, the spouse is deemed to have received a fair salary, which would be CP, and the rest of the asset is treated as that spouse's SP.

Pereira should be used where the increase in one spouse's SP is the result of that spouse's personal management. If this is the case, that spouse is given a reasonable return on his investment, which is treated as SP, and the rest of the asset is CP.

In this case, the brokerage account was personally managed by Winnie, who made the investment decisions herself. Although the nature of the underlying securities has some effect on the increased value of the account, its success is more likely due to Winnie's personal management - she was the one who chose to invest in those particular securities. Thus, a divorce court would likely use the Pereira method of accounting. Winnie should receive a reasonable return on her initial investment as SP, and the rest of the brokerage account should be treated as CP. The fact that Winnie's account is located outside of CA, in state X, does not matter; the law of the spouse's domicile (here, California) controls the characterization of personal property.

Thus, Winnie's brokerage account is part SP and part CP. The part that is SP will go to her on divorce, while the part that is CP will be split between her and Herb on divorce, according to California's equal division rule, i.e., all CP is to be split equally on divorce.

Community Property

Fran's Judgment for Child Support

All debts incurred during marriage are presumptively CP. However, a judgment for child support from a former spouse is considered the debtor's SP. Here, although the judgment was won during Herb and Winnie's marriage, because it is a judgment for child support from a former marriage, it is Herb's SP.

A spouse's SP judgment/creditor can reach that spouse's SP, and the spouse's CP, but cannot reach the other spouse's SP. If CP is used to pay an SP debt, the non-debtor spouse may be reimbursed for the payment. Here, Fran can reach Herb's SP, and can reach that part of the brokerage account that is considered CP, as described above.

Thus, Fran can enforce the child support judgment against that part of Winnie's brokerage account that is considered CP.

Medical Expenses

Any debt incurred during marriage is presumed to be CP. Here, Herb's medical expenses were incurred while he was married, and are therefore CP.

A creditor of a CP debt can reach the community's CP, and the debtor spouse's SP. Because this debt was for "necessaries," i.e., medical expenses, the creditor can also reach the other spouse's SP. If the debtor spouse has his own SP available to pay the debt, the non-debtor spouse can seek reimbursement for the payment of that spouse's debt. However, all of Herb's pension earnings (SP, as we shall see below) were used for living expenses, which would be presumed a gift to the community. He does not have SP left to pay his debts, and thus, Winnie cannot be reimbursed. Any debts incurred after the marriage are Herb's SP, and W is not liable for them.

Thus, the creditors may take their claims from Winnie's brokerage account, regardless of whether it is CP or SP.

Furthermore, at divorce, although CA has an equal distribution rule, a court may deviate from this rule when assigning debts to the parties. The court may protect creditors by assigning a debt to the party better able to pay it. In this case, it may be that Winnie is better able to pay, given her success with investments. If the court assigns the debt to Winnie, she will be personally liable for paying it. Herb, as the party who incurred the debt, will also remain personally liable. Thus, the creditors will be able to reach Winnie's brokerage account.

Herb's Pension

Assets earned before marriage are presumptively SP. CA considers pensions to have been earned when the spouse is working, as a type of deferred compensation, rather than considering them earned as the payments are made, like wage replacements.

Here, Herb stopped working before he married Winnie. Therefore, his right to his pension was earned completely before he married. Thus, the entire pension is his SP.

As stated above, because his SP was used to pay the family living expenses, Herb is presumed to have made a gift to the community of that amount. However, any future pension payments retain their SP character.

Winnie may argue that because Herb took early retirement for medical reasons, his pension should be treated as disability pay, which is CP to the extent it's intended to replace marital earnings. The court will have to decide whether these payments are more like deferred compensation or wage replacements.

Unless the court agrees that the pension is really a disability benefit, Winnie has no interest in it - it is entirely Herb's SP.

ANSWER B

California is a community property state. All property acquired during marriage is presumptively community property, unless it is received through gift, inheritance, or was owned by a spouse before marriage, in which case it is separate property. The initial characterization of assets can be changed by agreement, actions, or statutory presumptions.

Assets acquired outside of California which would be community property if acquired by domiciliaries of California are "quasi-community property." Quasi-community property is treated as community property on dissolution of marriage.

1. May Fran enforce the judgment for child support against Winnie's brokerage account?

A. Characterization of brokerage account

i. Source. Winnie acquired the brokerage account before marriage. It is therefore presumptively her separate property.

ii. Actions. However, Winnie actively manages the portfolio. The community is entitled to share in the growth of separate property businesses or actively-managed brokerage accounts. There are two different tests used to determine the community's share in such separate property enterprises.

First, the Van Camp test is used where capital is the primary source of growth Under Van Camp, the community is entitled to the value of the spouse's labor in management and the remainder of the appreciation goes to the separate property.

Under Pereira, the primary factor is a spouse's labor. For this test, the separate property is entitled to interest at the legal rate, and the rest of the growth is awarded to the community.

Here, Winnie's extensive activities call for the use of the Pereira test. She was an active manager, contacting her state X broker "on most days" to buy or sell stocks. Therefore, her separate Property interest is the amount of initial investment at the time of her 1990 marriage to Herb, plus interest. The community's interest is the remainder of the fund. Because all of the investment income has been reinvested, Winnie will be unable to argue that the community has already been benefited.

B. Liability of account for Herb's judgment

The separate property of a non-debtor spouse is generally not reachable by creditors of the debtor spouse. Here, however, the brokerage account is in part quasi-community property. Quasi-community property is treated as community property with regard to creditors' rights.

Community Property

The community's interest in Winnie's brokerage account can be reached to satisfy the judgment against Herb for child support. To the extent that Herb has any separate property, that property should be liable first. Here, however, as will be discussed below, Herb either has no separate property, or has exhausted it by making a gift to the community. If Herb should receive any separate property, the community could seek reimbursement.

C. Impact of separation/End of community

Income earned after permanent separation is a spouse's separate property. There is a separation when there is a permanent physical separation of the parties, with a communicated intent not to resume the marital relationship. Here, Winnie both moved away from Herb, which constitutes the physical separation, and filed for dissolution, which made her intent clear. Therefore, the community ended. Any income earned by Winnie's brokerage account after this separation is Winnie's separate property once again.

The community's share is only the increase during the existence of the economic community - from marriage until permanent separation - to the extent that such increase exceeds the legal rate of interest.

Fran is therefore able to enforce the child support judgment against the community property share of Winnie's brokerage account. Each spouse is given equal management, and so can enter into debts for which the community is liable. Herb's separate property should be addressed first, but the brokerage account can also be reached.

2. May Herb's Medical expense creditors recover their claims from Winnie's brokerage account?

A. Characterization of brokerage account

As discussed above, the brokerage account is partially separate property, and partially quasi-community property, which is treated as community property for creditors' purposes. Therefore, also as discussed, the community property is liable for one spouse's debts.

B. Debts for necessaries/Duty to support

Each spouse owes the other spouse support. This duty is absolute, and requires a spouse to use his or her separate property to the extent necessary to pay the debts for necessaries of the other.

Here, Herb has substantial, necessary medical expenses.

i. Debts incurred before separation

The entirety of Winnie's state X brokerage account may be reached by Herb's medical expense creditors. To the extent that Herb has any separate property, see below, it should be exhausted first. Next, the community's share of the brokerage account should be exhausted. Finally, if this is not sufficient, Winnie's separate property share may be reached.

ii. Debts after separation

As above, Herb's separate property, if any, and the community share may be reached for satisfaction of Herb's medical expenses. Winnie will argue that since the economic community ceased at the separation, her duty to pay Herb's medical expenses out of her separate property share also terminated. Herb will point out, however, that so long as they continue to be legally married, Winnie continues to be liable for debts for Herb's necessaries. Therefore, the analysis for all of Herb's medical expenses is the same.

3. What interest, if any does Winnie have in Herb's pension?

A. Time Rule: Pension plans are generally treated under a "time rule", giving the community a share based on the number of years worked during marriage, divided by the number of years worked to earn the pension. If this approach is applied, Winnie has no interest, because Herb had already begun receiving the pension at the time of their marriage, and all pension money would be Herb's separate property.

B. Income replacement?/Disability?

Unlike normal pension plans, however, disability payments or other income replacement funds are treated as income replacement. Therefore, money received during marriage would be community property. Here, Herb took early retirement, and has serious medical problems which strongly suggest that these payments were really income replacement. This money should, therefore, be treated as community property, to the extent received during marriage.

C. Transmutation?

Even if the money were separate property, Winnie could argue that there was a valid transmutation into community property. However, oral transmutations after 1985 are not valid, and there is no evidence of a written agreement. Therefore, this argument would fail.

D. Gift to community?

Also if the money were deemed to be separate property, Winnie would argue that Herb's payment of the couple's living expenses constituted a gift to the community. There are no presumptions regarding repayment which would come into play, so Winnie could triumph on this ground as well, in the unlikely event that the pension would not be treated as income replacement.

E. Treatment after separation

After separation, however, the income replacement pension is Herb's separate property, and Winnie has no valid claim to an ongoing interest. Herb can show that the community's share was exhausted by payment of their living expenses (using either direct tracing or recapitulation accounting if necessary - which it does not seem to be in the apparent absence of separate property belonging to Herb). Therefore, Winnie has no interest in any future pension payments. However, Herb will not be able to seek reimbursement for the living expenses, either.