

Question 1

In 1998, Henry and Wilma, residents of California, married. Henry had purchased shares of stock before marriage and kept these shares in his brokerage account. The shares in the account paid him an annual cash dividend of \$3,000. Henry deposited this income in a savings account held in his name alone.

In 1999, Wilma was hired by Tech Co. Wilma was induced to work for Tech Co. by the representation that successful employees would receive bonuses of company stock options. Later that year, Wilma was given options on 1,000 shares of Tech Co. stock. These stock options are exercisable in 2006, as long as Wilma is still working for Tech Co.

In 2003, because of marital difficulties, Wilma moved out of the home she had shared with Henry. Nevertheless, the couple continued to attend marriage counseling sessions that they had been attending for several months. Later that year, Henry was injured in an automobile accident. Afterwards, Henry and Wilma discontinued marriage counseling and filed for dissolution of marriage.

In 2004, Henry settled his personal injury claim from the automobile accident for \$20,000. The settlement included reimbursement for \$5,000 of medical expenses that had been paid with community funds.

Henry had a child by a prior marriage and, over the course of his marriage to Wilma, had paid out of community funds a total of \$18,000 as child support.

1. When making the final property division in Henry and Wilma's dissolution proceeding, how should the court characterize the following items:
 - a. Henry's savings account? Discuss.
 - b. Henry's personal injury settlement? Discuss.
 - c. Wilma's stock options? Discuss.

2. Should the court require Henry to reimburse the community for his child support payments and, if so, in what amount? Discuss.

Answer according to California law.

Answer A to Question 1

1)

California is a community property state. All property acquired during marriage is presumptively community property (CP). All property acquired before marriage or after permanent physical separation, or during marriage by gift, will, or inheritance, is separate property (SP). Upon divorce, marital CP assets are distributed 50-50 unless certain exceptions apply.

In determining the time for final property division, the probate court will look at when there was a permanent physical separation and an intent not to resume marital relations. This is when the economic community is considered to be at an end.

Here, the economic community did not end when W first moved out of the home due to marital difficulties, early in 2003. The couple continued to attend marriage counseling sessions, suggesting that they were still hopeful of a possible reconciliation. At the point, they did not have the requisite intent to not resume marital relations. The economic community ended later in 2003 when H & W discontinued marriage counseling and filed for divorce. Only at that time was it clear that there was a permanent physical separation and an intent not to resume marital relations.

1.a. Henry's savings account

Property acquired before marriage is that spouse's SP. All income, rents, and profits from SP earned during marriage is also that spouse's SP. Upon dissolution of marriage, the spouse who owns the SP will take it in its entirety. Although the character of property might change, what was initially SP will remain SP unless there has been a transmutation. No transmutation occurred here.

Henry purchased shares of stock before marriage and kept these shares in a brokerage account. Because the shares were purchased before marriage, they are his SP. The income from these shares, the annual cash dividend of \$3,000, is also Henry's SP. Furthermore, the income from the shares was deposited into a savings account held in his name alone. This suggests that the funds were not commingled with CP. In addition, it is assumed that W had no rights to withdrawal on the account.

Because the income deposited into H's savings account had as its source the stock he had purchased before marriage, all income in the savings account--assuming it was solely for such income and did not contain any commingled CP funds - - is H's upon divorce. W has no right to the income in the savings account.

b. Henry's personal injury settlement

A personal injury settlement that results from an injury sustained during marriage is presumptively CP. Legal relevance is placed upon when the injury occurred, and not on when settlement was awarded. Upon divorce, however, the injury settlement belongs to the injured spouse: it is treated as the injured spouse's SP. The community is, however, entitled to reimbursement for medical expenses paid with CP when SP was available.

Here, H was injured in an automobile accident that occur[r]ed in 2003, while he was still married to W. As stated above, at the time of the accident, H & W were no longer living together but were still attending marriage counseling sessions. Because there is no indication that H & W intended not to resume marital relations at this point, the economic community was not yet at an end. There was, at this point, no permanent physical separation. Because of these facts, the injury occurred at a time when H & W were still married and the settlement is thus CP during marriage.

On the given facts, the settlement was paid to H in 2004, after H & W had discontinued counseling and had filed for divorce. Thus, the economic community was at an end. Nevertheless, what is legally relevant is that the injury arose during marriage, and not the time the settlement was paid.

At the outset, upon divorce, the \$20,000 will be awarded to H as the injured spouse. It is treated as his SP. However, because \$5,000 of medical expenses were paid with CP, the community is entitled to reimbursement. Because H received an annual cash dividend of \$3,000, it can be assumed that he had \$5,000 in his separate savings account at the time the medical expenses were paid. Thus, because CP funds were used to pay his medical expenses at a time when H had SP available, the community is entitled to reimbursement.

The net result is that H will receive \$15,000 of the settlement. The community receives a reimbursement of \$5,000 which will be divided 50-50 between H & W.

c. Wilma's stock options

Stock options earned during marriage are CP to the extent that CP contributed to them. The court will apply the time rule to determine the pro rata share of contribution of CP and SP. Applying the time rule, a fraction is given whereby the numerator is the number of years that have elapsed between the granting of the options and the date the economic community of the marriage ended. The denominator is the number of years that have elapsed between the granting of the options and the year in which they are exercisable.

Here, the 1,000 shares of Tech Co. stock were awarded to W in 1999. The economic community of H & W ended in 2003. Thus, four (4) years of CP labor creates the numerator. The options are exercisable in 2006. Thus, the denominator will be 7.

The remaining 3 years, from 2004 to 2006, will be treated as W's SP.

Because 4 years out of 7 are attributable to CP, upon dissolution of marriage the community will be entitled to 4/7 of value of the stock options, while 3/4 will be W's SP.

2. Henry's reimbursing the community for his child support payments

Child support payments from a prior marriage are considered a spouse's premarital debt, regardless of whether the payments started before marriage or began during the marriage. Although CP and the debtor spouse's SP are both liable for any premarital debts of the debtor spouse, if CP funds are used during the marriage to make child support payments arising out of a prior marriage, and it is determined that the debtor spouse had available SP funds at the time, then the community may be entitled to a reimbursement upon divorce.

Here, H's child support payments arose out of a prior marriage. H had a child by a prior marriage – not the marriage to W. During the course of his marriage to W, H had paid out of CP funds a total of \$18,000 as child support. However, on the given facts, H had SP available to make those payments. He received \$3,000 annually in cash dividends from his stocks. Between 1998 and 2004, that amounted to \$15,000 (\$3,000 multiplied by 5 years). Moreover, he received \$20,000 as settlement for the personal injury claim which, although CP at the time received, is treated as his SP upon divorce.

Thus, because CP funds were used to make the child support payments, the community is entitled to reimbursement. H should be required to reimburse the community at least \$15,000 which is the amount he had accrued in his personal savings account during the course of the marriage. This amount can be offset from his personal injury settlement claim which will be treated as SP upon divorce. The amount is also \$15,000, after the \$5,000 has been deducted to reimburse the community. Furthermore, because half of the \$5,000 will go to H, that makes an additional \$2,500 available to reimburse the community for the child support payments.

In summary, on the given facts, H should be required to reimburse the community for \$17,500 for his child support payments.

Answer B to Question 1

1)

California is a community property state. As such, all things acquired between the date of marriage and date of separation are community property and are subject to a 50/50 division upon divorce. Separate property consists of assets acquired before the marriage or after the separation, as well as gifts, inheritances, and devises, and all the profits or rents thereon. Henry and Wilma were married in California in 1998, thus their divorce is subject to the community property system. In analyzing each of their assets it is important to keep in mind the source of the property and whether any subsequent changes in the character of the asset may have transmuted the property from community to separate or separate to community.

Henry's Savings Account

Henry purchased shares of stock before his marriage to Wilma and kept these shares in a brokerage account. These shares were thus Henry's separate property b/c he acquired them before marriage. The shares in the account paid him an annual cash dividend of \$3,000, which he deposited into a savings account in his name alone. The cash dividends are also Henry's separate property b/c all rents and profits garnered from separate property are separate property as well. This is true even though there is a presumption that all things acquired between the date of marriage and the date of separation are community property. The rule that rents and profits upon separate property is separate in nature trumps that presumption.

An asset which begins as community property may be transmuted into community property if a spouse manifests an intent to change the asset's character. Here[,] however, Henry has kept both the stock and the cash dividends in an account in his name alone. Therefore, he has not manifested an intent to transmute these stocks from separate to community property. Furthermore, after 1985 a transmutation must be in writing, signed by the spouse losing their interest, and state expressly that they are transmuting the property. Since none of that happened here, everything in Henry's savings account is his separate property.

Personal Injury Settlement

Personal injury settlements awarded during the marriage are community property. However, upon divorce the personal injury settlement will be awarded solely to the injured spouse unless equity demands otherwise. Here, Henry's right to his personal injury settlement arose during the marriage b/c Henry and Wilma were not legally separated at the time he was injured. To be legally separated, the couple must be living physically apart and manifest an intent not to resume the marital relationship.

Here, Henry and Wilma were living apart as of 2003. However, the couple continued to attend marital counseling sessions. Because the couple was still in marital counseling, they obviously did not have an intent not to resume the marital relationship. Rather, counseling suggests that they were trying to work things out. During this time period, Henry was injured. Henry may argue that he did not receive the actual settlement until 2004, at which point he and Wilma had filed for dissolution. However, since his injury and therefore his right to a claim arose during the marriage, the personal injury award will be considered to have arisen during the marriage.

Luckily for Henry, upon dissolution the personal injury award will be awarded to him entirely despite its initial community property characterization, unless equity demands otherwise. Wilma will argue that equity demands otherwise here b/c the community paid for \$5,000 of Henry's medical expenses. The community is obligated to pay for all of a spouse's "necessaries." This includes food, shelter, and medical expenses. Because the community had no choice but to pay for Henry's medical bills, a court would probably find that \$5,000 of the settlement should be awarded as community property. Under such an analysis, Wilma is entitled to \$2,500 (one half of \$5,000). Henry is entitled to \$2,500 and the remaining \$15,000 of the \$20,000 as his separate property.

Wilma's Stock Options

If a stock option is awarded during the marriage, then the community has an interest in it. This is b/c stock options are considered incentive compensation, meaning that they reward work currently going on. Therefore, if a stock option is awarded during marriage it is based at least in part upon past and present work in the hope that the employee will keep up the good job. Where the spouse is awarded the stock option during the marriage but exercisability occurs after the date of separation, a special formula must be used to extract the community's interest.

Here, Wilma was awarded the stock option in 1999 in recognition of her success as a new employee for Tech Co. She was married to Henry at that time and thus the community has an interest. Henry and Wilma separated in 2003 and the date of exercisability is 2006 (so long as Wilma is still working for the company.) The formula for extracting the community's interest mandates that the years between the date of the award and the date of separation be used as a numerator while the total number of years between the date of the award and the date of exercisability be used as a denominator. That comes to 4/7. Therefore, the community will be entitled to a 4/7 interest in the 1,000 stocks should they become exercisable.

Another issue is whether Henry can compel Wilma to exercise her stock options. In order to exercise them, Wilma must still be working for Tech Co. in 2006. At some point before 2006, Wilma may decide she no longer wishes to work for Tech Co. and therefore lose her interest. A court will not compel Wilma to continue working for Tech Co. The community merely has an expectancy in the stock options should she decide to eventually exercise them.

Whether the court should require Henry to reimburse the community for his child support payments

Where one spouse owes child support or alimony from a prior marriage, separate property funds should be used first to pay these costs. However, if separate property funds are not available, then the community is responsible for making these payments. Here, Henry had a child by a prior marriage and over the course of his marriage to Wilma he paid out \$18,000 in child support from community funds. That comes to \$3,600 per year. Since Henry had \$3,000 cash dividends coming to him each year as separate property, those funds should have gone to the child support payments first. Only \$600 per year of community funds should have been used (for a total of \$3,000 during the marriage). Therefore, the community is entitled to \$15,000 reimbursement for these child support payments. This means that Henry is entitled to \$7,000 and Wilma is entitled to \$7,000.

Henry may counter that the community is not entitled to reimbursement b/c he had co-equal powers to spend and incur debt with Wilma over the community property. This is true, however equity still demands that the community receive reimbursement since Henry should have depleted his separate property funds first.

Wilma could also make the argument that one spouse may not unilaterally make a gift of community property and that she may void such gifts while Henry is still alive. This is true. However, child support is more in the nature of an obligation than a gift. Therefore, this argument will be less successful.