

Question 6

In 2000, Harry and Wanda, California residents, married. Harry was from a wealthy family and was the beneficiary of a large trust. After their marriage, Harry received income from the trust on a monthly basis, and deposited it into a checking account in his name alone. Harry remained unemployed throughout the marriage. Wanda began working as a travel agent. She deposited her earnings into a savings account in her name alone.

In 2003, Harry and Wanda purchased a vacation condo in Hawaii. They took title in both their names, specifying that they were “joint tenants with the right of survivorship.” Harry paid the entire purchase price from his checking account, which contained only funds from the trust. Harry and Wanda orally agreed that the condo belonged to Harry.

In 2004, Harry purchased a cabin in the California Mountains to use when he went skiing. He paid the entire purchase price of the cabin from his checking account, and took title to the cabin in his name alone.

In 2005, Wanda commenced a secret romance with Oscar. During a rendezvous with Oscar, Wanda negligently operated Oscar’s car, causing serious personal injuries to Paul, another driver.

In 2006, Wanda received an e-mail advertisement inviting her to invest in stock in a bioengineering company. She discussed the investment with Harry, who thought it was too risky. Wanda nevertheless bought 200 shares of stock, using \$20,000 from her savings account to make the purchase. She put the stock in her name alone.

In 2007, Harry and Wanda separated. Shortly thereafter, as a result of the car accident, Paul obtained a money judgment against Wanda.

Harry and Wanda are now considering dissolving their marriage. The condo and cabin have increased in value. The stock has lost almost all of its value.

1. In the event of a dissolution, how should the court rule on Harry’s and Wanda’s respective rights and liabilities with regard to:
 - a. The condo in Hawaii? Discuss.
 - b. The cabin in the California Mountains? Discuss.
 - c. The stock in the bioengineering company? Discuss.
2. What property can Paul reach to satisfy his judgment against Wanda? Discuss.

Answer according to California law.

Answer A to Question 6

California is a community property state. There is a presumption that all property acquired during marriage is community property (CP). In general, community property is defined by what it is not – it is not separate property. Separate property (SP) is all property acquired by either spouse before marriage so after dissolution or acquired by inheritance. The rents and income from SP are also considered SP.

In the event of a divorce, CA requires all CP to be distributed equally between both spouses. This applies to all CP property as well as CP liabilities. Each item of CP should be distributed 50/50, unless economic circumstances warrant a different distribution. At divorce, the court has no jurisdiction to award SP. Each spouse keeps his or her own SP.

In determining whether an asset is classified as CP or SP, one must look to the source of the asset. One must also determine if either spouse has taken any action to recharacterize the property or if any presumption applies to the property.

1. Rights and Liabilities of Harry (H) and Wanda (W)

In determining the rights of H and W in all of the property at dissolution, each asset must be classified as either CP or SP.

(a) The Condo in Hawaii

Funds used to Purchase the Condo

The condo in Hawaii was purchased in 2003, while H and W were married. Since this was acquired during marriage, the general CP presumption is raised. H will attempt to rebut this CP presumption by tracing the purchase price of the condo. The condo purchased with money from H's checking account. This checking account contained only income from H's trust. These funds came from his inheritance only and (as mentioned above), money received during marriage from inheritance is characterized as SP and income from SP is characterized as SP. This checking account was never commingled with any CP funds and thus, all of the money in the account (the income

and any principal) would be SP. Further, H evidenced his intent to keep his money as his SP since he took title to the account in his name alone. Thus, the condo was purchased with SP funds.

Titled as “Joint Tenants with the Right of Survivorship”

Purchasing an item of property with SP funds does not alone classify the item as SP. One must also look to the title taken on the property. In this case, H and W took title as “joint tenants with the right of survivorship.” In Lucas, the CA court held that any taking of property in joint and equal form evidences an intent to take the property as CP. The CA legislature passed a statute known as the anti-Lucas statute, which has been in effect since 1984. Under this law, joint title is still considered CP (as in Lucas) but the court dictated how SP purchase money must be treated. Absent any written agreement between the spouses, the SP proponent will not have [been] apportioned into the joint tenancy property. If no written agreement is established, the SP proponent will only be able to assert a right to reimbursement for the amount paid towards the purchase price.

Therefore, in this case, although SP was used to purchase the condo, the condo would be characterized as CP. H and W orally agreed that the condo was H’s SP, but this agreement was not in writing and is thus unenforceable under the anti-Lucas statute. In the event of dissolution, H and W will each own a 1/2 interest in the condo and, thus, they will each be entitled to 1/2 of its appreciation amount. H will be reimbursed from the community for his SP contribution to the purchase price. Thus, he will be reimbursed the entire price of the cabin when it was purchased since his SP paid the entire amount.

(b) The Cabin in CA

The cabin was purchased in 2004 while H and W were married and, thus, the general CP presumption is raised. Again, H would attempt to rebut the CP presumption by tracing the purchase funds back to his SP checking account (discussed above). H paid for the entire purchase price of the cabin with SP funds.

He would also show his intent to keep his SP interest by showing that he took title to the property in his name alone. Taking title in one’s name alone is not enough to rebut the

CP presumption but when this is coupled with a purely SP purchase price, the SP proponent will be able to rebut the presumption and prove the property is SP.

Therefore, at dissolution, the cabin will be characterized as H's SP and it, along with its increase in value, will be awarded entirely to H. Since H did not use his cabin for any business purpose during the marriage, the community does not receive any ownership interest as a result of its increase in value during the marriage.

(c) The Stock

Funds used to Purchase the Stock

In 2006, W purchased stock in a bioengineering company. This stock was purchased during marriage and is presumed to be CP. The source of the funds used to purchase the stock came from W's savings account. The money in this savings account came entirely from W's earnings as a travel agent. The earnings of each spouse during marriage are considered CP. Thus, the money in the savings account was all CP.

W would attempt to show the money was actually her SP since the account was titled in her name alone. But, as mentioned, title in one spouse's name alone is not enough to evidence a SP interest. The SP proponent must also be able to trace the funds to SP monies or must be able to show that the other spouse gave a gift of his or her CP share. In this case, there is no evidence that H intended to gift away his CP interest in W's earnings. Further since 1985, any transmutation, which is any agreement to change the character of property during the marriage, must be in writing. There is no writing to evidence the intent to transmute these earnings from CP to W's SP. Therefore, the stock is considered all CP.

Management and Control of CP

Under CA CP laws, each spouse is given equal rights to manage and control the CP, unless a specific exception applies. Exceptions are realized for the sale of real property, for any gift of CP, or for any sale of the necessities within the home (such as furniture). If any of these exceptions do not apply, either spouse is permitted to unilaterally make decisions regarding the CP.

In this case, H might argue that he told W the investment was too risky and thus, the liability for the loss in the stock value should be hers alone. But this would not be a winning argument since W was permitted to unilaterally spend CP monies. None of the exceptions above apply to this situation. Stock is not real property. This was not a gift since W paid \$20,000 for the stock and the stock is not a necessity of the home.

Therefore, at dissolution, the liability for the loss in the stock value should be distributed equally between H and W.

Breach of Fiduciary Duty

H might also claim that W breached her fiduciary duty when she purchased this stock. In all marriages in CA, both spouses are considered fiduciaries of each other. They owe each other a duty of care and loyalty regarding CP funds. One spouse is permitted to make decisions regarding purchases and sales, but the spouse will breach his or her duty if he or she is grossly negligent or reckless in some CP transaction.

H will argue that W was at least grossly negligent when she refused to listen to his complaints regarding the purchase of the stock. He told her it was too risky and she was grossly negligent when she ignored this fact.

W would counter-argue that this was just a typical investment and there was no gross negligence. First, she had no knowledge that this stock was actually risky. All she had was H's opinion that the stock was too risky but this is not enough to show she was grossly negligent when she decided to purchase it. Second, even if she had some knowledge that the stock was risky, this is typical in most stock purchases. No stocks are guaranteed to make money and in almost all stock purchases, the buyer takes some sort of risk. This inherent risk does not equal gross negligence at all times. Since this was not a grossly negligent or reckless use of CP funds, H cannot prove that W breached a fiduciary duty and H cannot collect any losses in the value of the stock from W.

2. Property to satisfy Paul's Judgment

In general, a creditor of either spouse can reach the CP of the couple and the creditor spouse's SP to collect on the debt. This general rule applies to debts incurred during marriage as well as debts incurred prior to the marriage.

For certain kinds of judgments, there are rules that dictate how the creditor can collect from the spouse. For tort judgments, the rules depend on whether or not the tortfeasor spouse committed the tort while she was benefiting the community. If the tort was committed while the spouse was engaging in activity that benefits the community, the creditor must collect from the couple's CP first and then, if necessary, collect from the tortfeasor's SP. If the tort was committed while the spouse was not engaged in activity that benefited the community, the tort creditor must first collect from the tortfeasor's SP and then collect from the couple's CP if necessary to satisfy the entire judgment.

In this case, W committed a tort against P while she was married. This tort was committed while W was having a secret rendezvous with her lover Oscar. Thus, W was not engaging in an activity that benefited the community at this time. H had no knowledge of this activity and this activity certainly cannot be said to have benefited H. Therefore, P must first collect from W's SP to satisfy his judgment and then, if necessary, he can collect from the couple's CP. At no point is he permitted to collect from H's SP.

H may argue that this debt should be considered entirely W's SP debt because P obtained the judgment against W after H and W separated. Thus, he would argue that the debt was incurred after separation, when the community is no longer liable. H's argument would not be a winning argument. In determining liability for a tort, the liability will attach at the time the tort is committed, not at the time the judgment is actually obtained. Thus, a court will determine that W incurred this liability in 2005 when she injured P, not in 2007 when P finally obtained the judgment.

Thus, since this debt was incurred during marriage, the rules discussed regarding the order of satisfaction apply. P must first collect from W's SP but, at dissolution, W has no SP. Then, P must collect from the couple's CP. Here, the only property

characterized as CP is the stock and the Condo in Hawaii. P can reach the stock (even though it has almost no value) and then he can reach the increased value of the condo. In reaching the condo, he cannot collect from the share that H is entitled to for reimbursement of the purchase price.

Answer B to Question 6

Introduction

Because Harry and Wanda are residents of California, California law is applicable. California is a community property state. All property acquired during marriage by either spouse is presumptively community property. All property acquired by either spouse before marriage or after permanent separation, or by gift, will, or inheritance, is presumptively separate property. In determining the characterization of an asset, a court will look to the source of funds used to purchase that asset. A court will also consider any actions taken by the parties that may have affected its characterization, as well as any presumptions of law that affect the asset's character. Finally, the mere fact that an asset has changed form will not change its character. With the above principles in mind, we will now look at each asset in turn.

The Condo in Hawaii

Source

The source of funds used to purchase the vacation condo in Hawaii was from Harry's checking account. Harry's checking account is entirely composed of money that he received from a family trust. The money received from this family trust is considered a gift or inheritance. Thus, the money is his separate property. In addition, he did not commingle his separate property with the funds of the community, which might have given rise to a presumption that family expenses paid from those assets are community property. The title to the condo was taken in both spouses' names, and was taken as a joint tenancy with a right of survivorship. Thus, it was taken in joint and equal form.

Presumption: Joint and Equal Form

Where joint and equal title is taken to property which was acquired through a spouse's separate property funds, the Lucas and Anti-Lucas principles apply. The property itself is presumptively community property. Upon death, Lucas applies to hold that absent an express agreement to the contrary, the separate property which was used to acquire title in the property in question will be deemed to have been made as a gift to the community. Thus, the donor spouse has no claim of ownership or reimbursement. Upon divorce, the principles of Anti-Lucas apply. These provide that absent some

express agreement to the contrary or express wording in the deed, upon dissolution of marriage, the spouse who gave separate property toward the purchase of an asset that was acquired in joint and equal form is entitled to reimbursement for the down payment, improvements, and principal, but not an ownership interest.

Actions: Oral Agreement that the Condo Belonged to Harry

Spouses may make agreements or gifts that transfer property from one form to another, whether from separate to community or community to separate. This is called a transmutation. Since January 1, 1985, all transmutions must be in writing, signed by the party to be adversely affected, and must clearly indicate that a change in characterization is intended. In this case, the agreement between Harry and Wanda that Harry would own the condo was made orally. Thus, it is not a valid transmutation and this agreement did not change the characterization of the condo.

Disposition: Community Property with Right of Reimbursement

In this case, the parties are considering dissolution of marriage. Anti-Lucas will apply. This means that upon divorce, the condo is community property and Harry can claim a right to reimbursement for the purchase price of the vacation condo, since he paid this purchase price with his separate property funds. However, he is not entitled to an ownership interest in the condo. Therefore, any increase in the value of the condo belongs to the community and will be split evenly between Harry and Wanda.

The Cabin in the California Mountains

Harry purchased the cabin in the California mountains with money from his checking account. The money in his checking account was derived solely from the trust that he inherited. Because these funds are derived from inheritance, they were his separate property. He took title to the cabin in his name alone. Separate property includes all assets purchased entirely from separate property, unless some presumption such as that of joint and equal form applies. Because Harry did not take title in any joint and equal form, a presumption of a gift to the community does not arise under Lucas or Anti-Lucas. Thus, the cabin is Harry's separate property. Upon dissolution of marriage, Harry alone will take the entire cabin, including any increase in its value.

The Stock in the Bioengineering Company

Source

Wanda purchased stock in a bioengineering company using \$20,000 from her savings account. The money from her savings account was derived from her work as a travel agent. Salary that either spouse earns during the time of marriage is community property. Although Wanda kept her earnings in a separate account in her name alone, this does not change the fact that the funds are community property. Form of title is generally inconclusive. This fact might have been relevant if Harry had sought to use those funds to pay his own premarital debt. However, since that is not the case, then funds are community property. Thus, the stock was purchased with community property funds and will be presumptively community property.

Action: Title Taken in Wanda's Name Alone

Wanda took title to the stock in her name alone. Generally, the fact that a spouse takes title to an asset in his or her name alone does not change the presumption of community property, if the funds used to purchase that asset were community funds. In this case, the fact that Wanda took title to the stock in her name alone does not make the stock her separate property, unless it can be shown that some gift was intended. Wanda will likely argue that Harry intended to make a gift of the stock to her as her separate property, since he did not think the investment was a good idea and therefore did not want the investment for the community. However, it is unlikely that Harry's disapproval meant that he intended to make a gift of community assets to purchase the stock. Instead, Harry did not want Wanda to purchase the stock at all. Thus, he did not make a gift to her of the stock, and it will therefore remain as community property.

Action: Purchase without Harry's Permission

Under the equal management powers doctrine, either spouse alone may encumber, sell, or otherwise dispose of community assets. Thus, the fact that Wanda purchased the stock without Harry's permission will not change its characterization. In addition, Harry is not necessarily entitled to reimbursement for the community property that Wanda used to purchase the stock, since she had the power to use that money to purchase stock.

Duty of Loyalty

Each spouse owes a duty of the highest good faith, loyalty, and fair dealing to the other spouse. Neither may gain a financial advantage at the expense of the other. Also, neither may make a grossly negligent or reckless investment of the community's funds. In this case, Harry thought that the stock was too risky. If the stock was in fact so risky that investing in it was grossly negligent and reckless, Wanda will be said to have breached a duty of loyalty to her husband. If that is the case, she may have to reimburse him for his share of the community funds that were used to purchase the stock. However, the mere fact that Harry thought the investment was risky does not alone make it a reckless investment. Thus, it is unlikely that Wanda breached the duty of loyalty to her husband.

Disposition: Community Property

Because the stock was purchased with community funds and form of title did not change this, the stock is community property. It and its loss in value will be equally divided upon dissolution of marriage.

What Property can Paul reach to Satisfy his Judgment against Wanda?

Tort Liability

Where a spouse commits a tort during the marriage, the injured party can reach community assets and the separate property assets of the tortfeasor spouse. The order in which these items will be used to satisfy the obligation will depend on whether the tortfeasor spouse committed the tort to "benefit" the community. In this case, Wanda committed the negligent act while meeting Oscar, with whom she was having a secret romance. Having a secret romance with another man was not an action taken to benefit the community. Thus, the tort was not committed for the benefit of the community. This means that Paul may first reach Wanda's separate property, and then Paul may reach community property. Paul may not reach any of Harry's separate property, because Harry is not personally liable, and this is not a contract for necessities.

The Condo

The condo is community property upon divorce. However, where title is taken in the form of a joint tenancy with the right of survivorship, during marriage each spouse will own a 1/2 separate property interest in this property. This means that creditors of one spouse can only reach the 1/2 separate property interest of that debtor spouse. In this case, Paul may reach only Wanda's 1/2 separate property interest in the condo. This will be the first item that will be used to satisfy Paul's judgment, since it appears to be the only asset that is Wanda's separate property. Paul may not reach Harry's 1/2 separate property interest in the condo.

The Cabin

The cabin is Harry's separate property because it was purchased with his separate property funds and title was not taken in joint and equal form. Thus, Paul may not reach the cabin, since Harry is not personally liable and this is not a contract for necessities.

Harry's Checking Account and Trust Fund

Harry's checking account and his trust fund are his separate property. They may not be used to pay Paul.

The Stock

The stock is community property. Thus, once Paul has exhausted Wanda's separate property, if he has not satisfied his judgment he may proceed to use the stock as well.

Wanda's Savings Account

The savings account in Wanda's name is community property. Thus, it may be reached to satisfy Paul's judgment.