

First Supplement to Memorandum 80-88

Subject: Study D-312 - Enforcement of Judgments (Liability of Marital Property for Debts--Professor Bruch's Study)

Attached to Memorandum 80-90 is the study of the Commission's consultant, Professor Bruch, relating to management and control aspects of community property. As part of the study Professor Bruch deals with some matters covered by the Commission's tentative recommendation relating to liability of marital property, a copy of which is attached to Memorandum 80-88. Professor Bruch also deals with matters on which the Commission specifically requested information in connection with the liability recommendation, such as transmutation requirements and reimbursement rights.

This memorandum discusses the matters in Professor Bruch's study that relate to liability of marital property for debts, other than support judgments which we do not deal with at this time. The discussion below follows the order of the provisions in the tentative recommendation. This memorandum should be read together with Memorandum 80-88 which discusses the comments of other interested persons concerning the same points.

Civil Code § 4800. The Commission's tentative recommendation authorized unequal division of debts on dissolution where necessary to accommodate the rights of creditors. Persons who commented on this aspect of the recommendation were opposed to permitting an unequal division; rights of creditors should be accommodated to the extent practical within an equal division framework.

Professor Bruch at pages 39-40 argues for unequal division, to accommodate not only the rights of creditors but also to take into account the circumstances surrounding the inception of the debts. She proposes addition of the following language to Civil Code Section 4800(b):

Debts are not property subject to the rule of equal division of community property set forth in subdivision (a) but are to be divided as set forth in this subdivision. Debts for which the community property is liable shall be allocated to the respective parties or ordered satisfied out of the community property as the court deems just and equitable, taking into account the abilities

of the parties to pay and the facts surrounding the transaction or occurrence which gave rise to the debt. Such allocation shall be without prejudice to the rights of third parties.

Professor Bruch points out that despite the apparent vagueness of this test, the court should have little trouble in concrete fact situations deciding who should be obligated to pay.

While the court may have little trouble deciding, the parties may well disagree over who should be responsible for the debts. The staff foresees that such a provision would inject a whole new litigation factor in every disputed dissolution case. Many times certainty is a greater social good than equity. That appears to the staff to be the case here.

§ 5120.010. Liability of community property. Existing California law requires that a "separate" tort obligation be satisfied first out of the separate property of the tortfeasor and then out of the community property; a "community" tort obligation must be satisfied first out of community property and then out of separate property of the tortfeasor. Civil Code Section 5122. The Commission has tentatively recommended the repeal of this provision as it relates to creditors' remedies because it causes a number of difficulties. It requires a definition of what constitutes separate and community torts, a forum for determining whether the tort is separate or community, a means by which a creditor can ascertain whether particular property is separate or community, and a means for determining whether the separate or community property has been exhausted.

If either spouse is working and earning wages (which are community property) can the creditor ever reach separate property in light of the fact that new community property is being continually created? If the only community asset is the family home, can the creditor go against separate property on the assumption that the homestead will be claimed or must the creditor levy on the homestead and then wait and see whether the homestead is claimed and if so whether the court will determine the claim is valid? All the collection hearings and procedures will be reasonable and necessary collection costs paid for by the spouses.

It appears futile to attempt to deal with the innumerable problems created by a priority scheme. The Commission has tentatively decided

that if community or separate property is to be primarily liable for debts (a question which the Commission has not yet resolved), this should be accomplished through a reimbursement right.

Professor Bruch at pages 23-29 of her study argues that the tort priority scheme of Civil Code Section 5122 should be preserved and implemented. Her argument is that a priority scheme protects emotional and financial needs of the spouses and that it is only fair that a separate tortfeasor's separate property be primarily responsible for the tort. "The marginal benefit to a tort plaintiff in removing such orders of priority does not justify the harm to family members that would be condoned by a repeal of Section 5122."

Professor Bruch points out that in many cases insurance proceeds will be available to pay a tort obligation or there will not be both community and separate wealth, so priority issues will not arise. In other cases, characterization of a tort obligation as separate or community could be accomplished by special verdict in the tort action or by procedures such as a suit to stay enforcement against certain assets or upon a motion for marshalling of assets.

Professor Bruch at page 31 proposes creation of a new priority scheme in the case of prenuptial debts, "making the debtor spouse's separate property primarily liable, with the community property other than the nondebtor's earnings only secondarily liable." The reason for this proposal is "there appears to be widespread agreement among married people that a debtor spouse's separate property and current earnings should be used to make payments on obligations that predate his or her marriage."

An order of priority for prenuptial debts would create the same sorts of administrative problems as an order of priority for tort debts, with one exception. The question whether a particular debt is pre- or post-nuptial would be readily ascertainable and would not likely be an issue in the proceedings.

Professor Bruch also suggests in connection with liability for prenuptial debts that the Commission may wish to consider whether the separate property of the nondebtor spouse should also be liable after exhaustion of the separate property of the debtor spouse and the community property. This liability would parallel that of the nondebtor

spouse for necessary debts incurred during marriage pursuant to the mutual support obligation of the spouses. Professor Bruch points out that liability of the nondebtor spouse would help avoid the danger of "marital bankruptcy" that might otherwise attend the decision of a spouse to become a homemaker and ignore outstanding obligations.

Professor Bruch recommends at pages 38-39 that an order of priority of resort to marital property should also be enacted for contract debts. This would "make more concrete the obligations of good faith management imposed by Civil Code Section 5125(e), while retaining creditor access to both community and separate property funds during marriage for the satisfaction of all debts incurred by the spouses."

The problems in classifying contract obligations as "community" or "separate" would be more serious than the problems in classifying tort obligations. They would arise much more frequently, in a greater variety of situations, and would not ordinarily be covered by insurance. Are debts for "luxury" items community or separate? Is a mink coat a luxury? A camel's hair coat? A leather coat? What about excessive alcohol purchases for personal consumption? At what point does it become excessive? Such a characterization problem would invite continual litigation and would complicate the debt collection process greatly.

§ 5120.040. Interspousal transfer. The Commission has tentatively recommended codification of the rule that the Uniform Fraudulent Conveyance Act governs interspousal transmutations of property. Professor Bruch agrees with this recommendation but suggests at pages 67-68 that Civil Code Section 3440 should not apply to interspousal transfers.

Section 3440 provides that a transfer of personal property by a person having possession or control of the property is conclusively presumed fraudulent as to creditors if the transfer is not accompanied by an immediate delivery followed by an actual and continued change of possession of the property. This provision has been applied to transfers between husband and wife. Professor Bruch points out that, "Although a sham may legitimately be inferred in most cases in which a change of possession does not occur, Section 3440 does not reflect reality in the domestic context." It would enable creditors to avoid almost all interspousal transfers of personal property since spouses who share the same household will almost always be held to share "possession" of their personal property.

The staff believes this is a good point. We do note, however, that Section 3440 by its terms already excludes from its operation transfers of property that is exempt from execution. This would include most common household goods and personal effects, so that the only interspousal transfers to which Section 3440 applies would be ones involving unusual or non-household property, such as business assets. For this purpose, Section 3440 may be adequate as it stands.

The Commission specifically requested Professor Bruch's advice on the question whether there should be any formalities required for an interspousal transmutation of property, apart from any creditors' interests. Professor Bruch at pages 56-57 argues against imposition of a writing requirement. She points out that family transactions are characterized by informality and the parties should not be penalized by that informality. Interspousal agreements should be honored. Professor Bruch goes on to state at pages 68-69 that no special requirements should be imposed to affect rights of creditors, either. She points out that the pool of property available to creditors is already large and that a special statute of frauds for married persons would discriminate against marriage, contrary to the policies of encouraging marriage and protecting the family unit.

The concern the staff has with this position is that the question whether there has been a transmutation of property is one of the most litigation-causing issues in a dissolution proceeding. Property settlements might be considerably more trouble-free and there might be fewer contested proceedings if transmutation were removed as an issue. The staff has no specific suggestions at this time, but we do believe that the possibility of a writing requirement should not be rejected out of hand. The Commission should remain open to consider a rule even that would preclude transmutation of community to separate property during marriage except pursuant to a formal agreement.

§ 5120.030. Liability for necessities. Under existing law the separate property of the non-debtor spouse is liable for debts for necessities of the debtor spouse incurred while the spouses are living together after exhaustion of the community and quasi-community property. After separation the separate property of the non-debtor is not liable

unless the spouses are living separate and apart pursuant to an agreement requiring the non-debtor to support the debtor. The Commission's tentative recommendation extends the liability of the non-debtor spouse after separation unless the support obligation is specifically waived by the spouses. However, the extension of liability covers only "common" necessities, so the separate property of the non-debtor spouse is not liable to claims of creditors based on a "station-in-life" test.

Professor Bruch at pages 69-73 urges that the liability of the non-debtor spouse in this situation not be limited to common necessities debts. She points out that limitation to common necessities debts will hurt persons who have extended credit not knowing that the spouses have separated and who may have every reason to believe that the spouses will continue to be responsible for their debts as they have been in the past for necessities expenditures.

Reimbursement. Professor Bruch's general approach to liability of marital property for debts is that community property should be primarily liable for "community" debts and separate property should be primarily liable for "separate" debts. If one type of property is applied to satisfaction of a debt of a different type, does a right of reimbursement arise?

Professor Bruch advocates a dual approach. See pages 92-97. If community property is applied to satisfy a separate debt at a time when no separate property was available to satisfy the debt, the community would not later be entitled to reimbursement from the separate property of the debtor. If, on the other hand, community property were applied to a separate debt at a time when separate property was available, a right to reimbursement arises. "In order to encourage the payment of debts as they fall due, there should be no ambiguity about the result and availability at the time of normal payment should be the test."

The reimbursement right would be enforceable by litigation between the spouses during their marriage or by appropriate division of the marital property at dissolution. "To provide redress for interspousal wrongs while preserving marriages wherever feasible, the law should recognize that although some spouses may be prepared to undertake interspousal litigation (and that speedy and fair relief is called for in such cases), many others are not." Study at p. 87.

The staff has serious reservations about the advisability of permitting interspousal litigation during marriage. If reimbursement rights are to be provided at all, it should be upon dissolution. It seems to us that spouses should be required to work out their management problems between themselves--the state should not provide a forum or referee for their squabbles unless they wish to no longer remain married. As a practical matter, if hostilities between the spouses have reached the point where they are suing each other over their property, interspousal litigation will probably precipitate a divorce action anyway. And suppose one spouse recovers judgment against the other spouse; how will the judgment be enforced? If the bickering spouses are intransigent a voluntary settlement is unlikely. Will the creditor-spouse invite the sheriff in the house with a writ of execution to seize property of the debtor-spouse? Must the property be sold on execution; if not, how is its value to be determined? After all this, is it likely that the property of the creditor-spouse will remain safe from self-help retaliation by the debtor-spouse? The staff thinks it would be inadvisable to embark on this path.

The staff has serious reservations as well about allowing reimbursement at the time of dissolution. This will permit the spouses to go back through their marriage, with all the financial transactions that have taken place, in an effort to characterize some of the long-paid debts as community and others as separate, and to determine which community debts were satisfied out of separate funds and which separate debts were satisfied out of community funds. The complications and accounting problems that would arise in sorting and tracing property and obligations over a marriage of any length would be extraordinary. Issues involving characterization of types of debts would be commonplace in every dissolution proceeding.

The staff suggests that if it is felt necessary to provide a reimbursement right, the right might be limited to transactions that occurred within a short time before dissolution--say six months or one year. Such a statute of limitations would have the effect of simplifying the evidentiary and accounting problems, and would also pick up transactions that occurred at a time when impropriety is most likely--as

the spouses are heading toward dissolution of their marriage. However, the staff questions the advisability of a reimbursement right at all.

Respectfully submitted,

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