#F-640 1/11/83

Second Supplement to Memorandum 82-103

Subject: Study F-640 - Marital Property Presumptions and Transmutations (Mixed Assets--Comments of Professors Reppy and Goda)

The First Supplement to Memorandum 82-103 includes a draft of provisions to the effect that a marital asset is part community and part separate, based on the community and separate contributions for its acquisition, production, or improvement. This would codify existing law as to the nature of marital property acquired in part with community funds and in part with separate funds. However, existing law takes a different approach as to separate property improved with community funds; in this case the asset is classified as separate property and the community has a right of reimbursement.

In essence, existing law adheres to the original civil law "inception of title" theory of ownership in the case of improvements to marital property, but has evolved to a "proportionate ownership" theory in the case of acquisition of marital property. This progression is described in the First Supplement to Memorandum 82-103. The First Supplement goes further and applies a proportionate ownership theory to both acquisition of, and improvements to, marital property.

Professor Reppy writes (Exhibit 1) to object to this extension of the proportionate ownership theory. He states that proportionate ownership ("buy-in") for acquisitions has caused a lot of problems; the problems would be compounded by extending the buy-in approach to improvements of marital property. The specific problems Professor Reppy identifies relate to creditors' remedies. If a large separate property asset such as a house or yacht is improved with a small amount of community property, a creditor of the non-separate property spouse would be able to reach the community interest in the house or yacht to satisfy a debt, and an assignee for the benefit of creditors or trustee in bankruptcy of the non-separate property spouse would be able to assert community ownership rights in the house or yacht. In Professor Reppy's opinion existing law is preferable that classifies the house or yacht as separate and gives the community a right of reimbursement for the improvement. "The right of reimbursement remedy causes less problems. The value of the right can be measured so that appropriate (if any) share of gain goes to the improving estate."

The staff does not agree with Professor Reppy that the right of reimbursement is simpler. To begin with, as he recognizes, the reimbursement right must be adjusted somehow to reflect any appreciation of the improvements made with community funds; the proportionate ownership approach of course does this automatically. Second, although a community creditor is precluded from reaching any of the "separate property" under the inception of title approach, the creditor can reach and collect upon the community's reimbursement right; this is a much more complex process than levying upon the property directly and probably will ultimately end in seizure of the separate property anyway to enforce the reimbursement right. Third, Professor Reppy's hypotheticals are easily altered to show how the inception of title theory is inequitable to creditors; in the case of a separate property asset of relatively small value that has been improved with substantial amounts of community property (e.g., a separate property lot developed with community funds), a community creditor would be unable to reach the large community pool simply because it was classified as "separate property" under the literal application of the inception of title theory. Worse, under the inception of title theory such an asset would not be subject to any community property management and control protections but would be subject to the sole discretion of the original separate property owner. One must also ask whether there is anything wrong in allowing a community creditor to reach the proportionate community share of an asset improved with community funds; creditors regularly reach debtors' shares in concurrently held assets outside the marital property context, without overwhelming problems; special community assets such as the home, household furnishings, personal effects, automobile, etc., are protected by the exemptions from enforcement that apply to assets of this type.

Under Professor Reppy's approach a separate property house on which mortgage payments are made during marriage with community funds and on which an improvement is made with community funds would be treated as proprtionately owned by the community to the extent of the community acquisition, but the community improvements would be recognized only through reimbursement. Is there a sound policy supporting this disparity in treatment and the complexity it engenders? The situation is exacerbated where the house is refinanced during marriage in order to construct

an improvement, so that consolidated payments are made with community funds that are being applied to both purchase and improvements, without distinction. How are payments to be segregated into acquisition (which yields proportionate ownership) and improvement (which yields a reimbursement right)?

Although the staff agrees with Professor Reppy that the proportionate ownership approach has problems, the staff does not agree that the reimbursement approach has fewer problems. The staff believes that a stronger argument can be made for the proportionate ownership approach on policy grounds, and that in any case it makes sense to consolidate the different areas of the law and apply only one rule to acquisition and improvement of marital property.

Professor Goda writes (Exhibit 2) with a different point. In our draft of the proportionate ownership statute, we state that a mixed asset "is part community and part separate property to the extent of the proportionate community and separate contributions to its acquisition, production, or improvement." Professor Goda points out that although we intend to leave the determination of the amount of the shares to case law, use of the word "proportionate" implies a strict mathematical formula. He suggests the word "proportionate" be omitted from the draft to eliminate some interpretation problems. The staff agrees the word could be omitted without changing the sense of the section.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

EXHIBIT 1

Duke University
DURHAM
NORTH CAROLINA

SCHOOL OF LAW POSTAL CODE 27706

January 4, 1983

Nathaniel Sterling
California Law Revision Commission
4000 Middlefield Road, Room D-2
Palo Alto, California 94306

Dear Nat:

Your first Supplement to Memorandum 82-103 is disturbing to me. Your proposal to provide for a "buy-in" for improvements made by one estate (in a nongift context) by funds of the other estate will have unfortunate consequences. At least I consider them that.

Suppose I separately own a house worth $198,000 and marry and use $2000 of community property to add on a screen porch. My wife's tort victim gets a judgment against her. Your proportionate ownership theory means the judgment lien attaches against the 1% community ownership interest in the house and levy of execution can be had against the house. Is that wise?

Suppose it is not a separately owned house but a yacht worth $99,000, and $1000 of community funds is used to install brass fixtures. My wife now goes deeply into debt and makes an assignment for benefit of creditors or is thrown into bankruptcy. She (or the trustee) under bankruptcy can alienate the 1% interest in your "buy-in" theory. The trustee apparently can assert full ownership rights of a tenant in common owner.

Existing law is preferable. The right of reimbursement remedy causes less problems. The value of the right can be measured so that appropriate (if any) share of gain goes to the improving estate.

One of the reasons for civil law inception of title was to keep wife's separate property separate so there would be unified management. California long ago tossed aside inception of title for pro rata sharing of where purchase money came from different estates. This has caused a lot of problems. You just compound them by extending the "buy-in" approach to the improvement context.

I hope the commission will rethink this.

Sincerely,

Bill

William A. Reppy, Jr.
Professor of Law

WAR/sa

THE UNIVERSITY OF SANTA CLARA

SCHOOL OF LAW
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January 7, 1983

Mr. Nat Sterling
Assistant Executive Secretary
California Law Revision Commission
4000 Middlefield Road, Room D-2
Palo Alto, California 94306

Dear Nat:

I write to send some comments on Study F-640--Marital Property Presumptions and Transmutations (Mixed Assets), First Supplement to Memorandum 82-103.

I agree that the recommendation should not be submitted to the 1983 legislative session even if the Commission approves it as drafted. You are correct in recognizing that the law governing presumptions and transmutations should be fully resolved.

Let me make the following observations:

1) The words reimbursement and apportionment are sometimes used as synonyms, sometimes used in different senses. When they are used in different senses, the word reimbursement usually means giving back on a dollar for dollar basis, either because of agreement or because the property was mismanaged in some way. Apportionment almost always applies to a share in the title where there has been a mixture of community and separate property in an asset. Warren v. Warren 28 CalApp3rd 777, 104 CalR 860 (1972) illustrates the tension in the meanings. I cannot understand the court's finding of constructive breach of fiduciary duty just for mixing assets in this kind of case. The court then goes off on allowing either reimbursement or apportionment, whichever is greater.

In any event, the problem relates to the difference between giving back what has wrongfully been taken and a sharing in title. I think the draft only relates to the latter.

2) You are correct in wanting to leave the problems of specification of proportions to a later time or case development. But if that is so, perhaps you should leave out the word "proportionate" in your proposed CC 5110.310(a). Proportion in the strict mathematical sense relates to straight fractions--this works in the insurance cases which you mention in n.1 on p. 2 of the draft. But cases like Pereira and VanKamp 156 Cal 1 and 53 CalApp 17 apportion community property and

separate property where time, labor and skill have been put into separate property investments but not according to the strict sense of "proportionate." Leaving out the word proportionate does not change the sense of your section but may eliminate some interpretation problems.

Enough.

Sincerely,

Paul J. Goda, S.J.

PJJ:jb