#D-312 12/23/81

Memorandum 82-2

Subject: Study D-312 - Debtor-Creditor Relations (Liability of Marital Property for Debts and Obligations)

Background

The Commission in the spring of 1980 developed a tentative recommendation relating to liability of marital property for debts. This tentative recommendation was distributed for comment in the summer of 1980. The comments were considered in the fall of 1980. At that time the Commission made a number of tentative decisions for revision of the recommendation and the staff prepared a revised draft. However, several major issues were reserved until the Commission received the final portion of Professor Bruch's community property study, since any recommendations made in the study concerning reimbursement rights and division of property at dissolution could affect the Commission's decisions on the liability issues.

The Commission now has in hand Professor Bruch's study, and is in a position to wrap up its work on liability of marital property for debts. In the intervening time we have also received comments from June S. McGee of Union Bank (addressed to the original tentative recommendation), from the State Bar Business Law Section (addressed to the revised draft prepared by the staff), and from the State Bar Community Property Committee (South) (addressed to the original tentative recommendation). The staff believes the most efficient way to proceed is to start from the original tentative recommendation, which highlights the issues. The comments originally received on the tentative recommendation should be reviewed together with the proposals made in Professor Bruch's study and the newly received comments. In the course of the review the staff will note tentative decisions the Commission made previously, where relevant.

The Tentative Recommendation

The tentative recommendation relating to liability of marital property for debts was developed from Professor Reppy's study for the Commission. The study is now published in somewhat different form as "Debt Collection from Married Californians: Problems Caused by Transmutations, Single-Spouse Management, and Invalid Marriage," in 18 San Diego Law Review 143 (1981). A copy of this law review article has been sent to you with previously distributed materials for the January 1982

meeting. A copy of the tentative recommendation is attached to this memorandum. The major features of the tentative recommendation are:

(1) The tentative recommendation preserves California's existing system that all the community property and the debtor's separate property are liable for debts.

(2) The tentative recommendation eliminates the few situations in California law where an order of satisfaction scheme requires a creditor to exhaust one class of assets (e.g., separate property of the debtor) before proceeding to another class of assets (e.g., community property).

(3) The tentative recommendation reverses the existing provision that protects the separate property of a nondebtor spouse after separation from liability for the support of the debtor spouse unless support is stipulated in the separation agreement--under the tentative recommendation, the separate property would be liable unless support is waived in the agreement.

(4) The tentative recommendation codifies the rule that the Uniform Fraudulent Conveyance Act applies to interspousal transfers and transmutations, but would impose no further limitations pending a broader study of interspousal relations.

(5) The tentative recommendation abrogates the rule that the creditor may seek former community property in the hands of the nondebtor after dissolution and division of assets--the court in dividing the property would assign the debts for payment taking into account the rights of creditors and the person assigned the debt would be personally liable.

Other lesser and clarifying changes in the law are also proposed.

General Observations

A practicing attorney, Mr. Dennis Cornell (Exhibit 4), agreed with the general trend of the Commission's proposals and felt that they would encourage the extension of credit to individual spouses. Another practicing attorney, Mr. Luther Avery (Exhibit 2), disagreed with many of the Commission's proposals and suggested that we seek the comments of the State Bar Family Law Section. In fact, we have sought the comments of the State Bar and Ms. Sandra Musser (Exhibit 3) has replied on behalf of the Executive Committee of the Family Law Section. They feel that the area of debts and community property and marital dissolution is one that needs a thorough examination and new legislation, and they have

offered us their assistance in this area (an offer we have gladly accepted). We also have the comments of the State Bar Business Law Section (and its Debtor/Creditor Committee), which generally supports the Commission's recommendations with the exceptions discussed below. See Exhibit 6.

June S. McGee (Exhibit 5) suggests that in thinking about liability of marital property, it is useful to distinguish between the legal incidents of the property for purposes of relations between the spouses and the liability of the property to claims of creditors. To emphasize this distinction, she proposes the concept of SCR property ("subject to creditors rights"), which may or may not be coextensive with community and separate property, depending on the specific rules applied to it. In addition to the conceptual treatment of SCR property, Ms. McGee also proposes a fairly radical practical treatment: all property of either spouse, separate as well as community, becomes SCR property through the passage of time. "Simply put, it means that after some time period, e.g. three years, five years, seven years, the marriage will have stabilized so that the spousal interests have merged to the point where both spouses benefit from the obligations and investments of the other. At this point in time, both spouses should take responsibility for the debts of the other." Ms. McGee argues that after two persons have been married for seven years, it may be assumed they know well what to expect from each other by way of debt and liability, and it is not inequitable for them to share their responsibilities. Specific application of this general concept will be developed in more detail below in connection with individual issues.

§ 5120.005. Debts

Subdivision (a). Section 5120.005(a) defines "debt" to include both tort and contract obligations "unless the provision or context otherwise requires." The State Bar Business Law Section (Exhibit 6) believes this creates an ambiguity and that those contexts where the definitions do not apply should be identified. The staff disagrees; the reason for the context provision is that exceptions are often apparent from context even though not always plainly labeled. For example a special provision relating to a tort debt or a debt based on a support obligation may characterize the type of debt initially and thereafter refer to it simply as a "debt"; the context is clear that it is a tort

debt or a debt based on a support obligation that is referred to and qualifying language should not be required each time the term "debt" is used in the special provision.

The definition of debt also refers to obligations "incurred by a spouse." The State Bar Business Law Section points out that this phrase seems to imply that the statute only applies to debts incurred by a person while married, whereas in fact the statute applies to debts incurred both before and during marriage. The staff believes the point is well taken and will refer to a debt incurred by a spouse "before or during marriage."

Subdivision (b). Section 5120.005(b) states that a debt based on contract is "incurred" at the time the contract is made. The State Bar Business Law Section is concerned that liability of the community based on the time a contract is made may be inappropriate in the case of a long-term contract that is breached after separation or dissolution. This is really a problem of allocating responsibility at separation or dissolution for payment of debts incurred during marriage. This problem is discussed below under Section 5120.050(a)(2).

§ 5120.010. Liability of community property

Subdivision (a). Section 5120.010(a) provides that all of the community property is liable for debts of any kind, tort or contract, incurred before or during marriage. Mr. Avery (Exhibit 2) is opposed to this basic scheme. He believes that it is based on a false assumption of equal management and control of community property, whereas in practical fact there is not equal management and control--either one spouse manages and controls the community property or each spouse manages and controls the community property acquired with that spouse's earnings. As a consequence, Mr. Avery does not believe that the community property should be liable for the debt of a spouse unless the other spouse has signed for the debt or unless the separate property of the debtor is exhausted, in which case the debtor's half of the community property only would be liable.

What Mr. Avery is proposing is in effect the New Mexico scheme with all its attendant problems--classifying a debt as community or separate, classifying marital property as community or separate, partitioning the community property. Mr. Avery recognizes the problems but believes they will be resolved by creditors refusing to extend credit unless both

spouses sign. He believes this will have the salutary effect of cutting down the over-liberal extension of credit; he also believes that the rights of creditors should not be strengthened.

The staff disagrees. Public policy favors the extension of credit to individuals who happen to be married. Moreover, the law should strive to make it feasible for creditors to collect their debts; the staff can see no legitimate reason to make debt collection from married persons procedurally or substantively difficult. We believe the policy of the Commission's tentative recommendation is sound and should not be altered.

Subdivision (a) makes clear that all community property, not just the community property under the management and control of the debtor spouse, is liable for the debts of either spouse. This would include a community property business solely managed by the nondebtor spouse and a community property bank account standing in the name of the nondebtor spouse alone. This clarification is specifically approved by both June S. McGee (Exhibit 5) and the State Bar Business Law Section (Exhibit 6). Ms. McGee notes that there remains a tracing burden for community and separate funds in a bank account and suggests that if separate property of the nondebtor account holder is also made liable this problem would be eliminated. The concept of making separate property of the nondebtor spouse liable is discussed below under Section 5120.020.

Subdivision (b). Section 5120.010(b) creates an exception to the liability of the community property for debts of a spouse--the earnings during marriage of the nondebtor spouse are not liable for a prenuptial debt of the debtor spouse. This is existing law. See Code Civ. Proc. § 5120. Consistent with his position on liability of community property generally, Mr. Avery does not believe that community property should be liable at all for prenuptial debts of the spouses since liability "works an added hardship on a new marriage and contributes to marital discord." He favors a rule that "community property is not available to prenuptial creditors until all separate property is exhausted and possibly also until two years after marriage."

Mr. Avery's position is based on the notion that prenuptial debts are separate in nature and therefore only the debtor's separate property should be liable for them. However, once the debtor marries, the debtor's earnings are community property, as are assets acquired with commu-

nity property. To deny creditors access to the community property for a prenuptial debt is plainly unfair to them. Professor Reppy's comments concerning the Washington/Arizona system that limits liability for separate debts to separate property are enlightening:

> The lack of logic in the concept underlying the Arizona system is further evident from the fact that both Washington and Arizona in the last decade had to engage in some legislative tinkering to avoid near absurdity. By the logic of the system, an obligation incurred by H or W alone before they marry could not have been incurred to benefit the community (as none existed). Thus it was a separate debt. Yet as soon as the debtor spouse married, his earnings--sole source of wealth for may obligors--were community and not liable for the "separate" obligation. Marriage by a debtor in this situation was called "marital" bankruptcy. The remedial legislation in Arizona gives creditors considerable relief from "marital bankruptcy." To a much lesser extent, the Washington remedial act allows antenuptial "separate" creditors to reach some community assets. 18 San Diego L. Rev. at 173, n. 115 (citations omitted).

One obvious solution to the conflicting policies involved here, and the one adopted in California, is to allow the prenuptial creditor to reach community property but not the community property earnings of the nondebtor spouse. This solution speaks to the case that bothers Mr. Avery the most--"where the debtor spouse is not earning the community income and the earnings of the innocent earning spouse are partially available to prior creditors."

This solution does not satisfy Justice Kingsley, however. See Exhibit 1. He believes the California system still permits a form of "marital bankruptcy":

> Marriage should not be a substitute for bankruptcy. But the rule exempting the "earnings" of a spouse for premarital debts of his new spouse operates exactly that way. A person (more usually but not necessarily a woman) incurs debts she (or he) prefers not to pay. She (or he) discovers a prospective spouse with good earning capacity but no substantial savings, marries, and thumbs her (or his) nose at the creditors. Neither good policy nor common sense can support such a system.

The Commission's draft would satisfy Justice Kingsley's concern somewhat by providing that the earnings of the nondebtor spouse are immune from liability only so long as the earnings are identifiable and traceable in deposit accounts. Once the earnings are converted into other forms of community property, they become liable to the prenuptial creditors. While the staff is not completely happy with the artifi-

ciality of this dividing line, it seems to make some practical sense. The State Bar Business Law Section believes the right to trace wages of the nondebtor spouse is an important clarification of the law.

Another possible solution is offered by Professor Bruch at page 31 of the management and control study. She proposes "making the debtor spouse's separate property primarily liable, with the community property other and the nondebtor's earnings only secondarily liable." Under this scheme a creditor would have to first exhaust the debtor's separate property before proceeding to the community property. 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."

The staff is strongly opposed to an order of satisfaction for property. It creates tremendous administrative and practical problems and imposes a substantial burden on the creditor seeking to collect a debt. It imposes an increased burden on the judicial system. Some of the problems are developed immediately below under "Order of satisfaction for property." In the staff's opinion a better approach would be to permit the creditor to satisfy the prenuptial debt out of either separate or community assets and to allow the community reimbursement to the extent community assets were taken.

Yet another solution is suggested by June McGee (Exhibit 5). Ms. McGee proposes that debts of either spouse incurred before marriage should become the liability of all the community property (including earnings of the nondebtor spouse) after a reasonable time interval, e.g., five years after marriage. Under this proposal no tracing or determination of a change in form for earnings of the nondebtor spouse would be necessary after five years. Ms. McGee proposes in addition that after a further reasonable period, e.g., seven years of marriage, both the community property and the separate property of either spouse should be liable for all debts of either spouse incurred before or after marriage, with the exception of tort liability. Ms. McGee states:

> Arguments as to the equities involved in making separate property liable for pre-marital debts after seven years are countered by the fact that most pre-marital debts are paid off by that time. If there were support obligations for children of a prior marriage, they may have grown past the age where parental support

> is legally required or will not have too much longer to go. If making the earnings of the subsequent spouse liable for such support after five years places a burden upon the subsequent marriage, perhaps this is where it belongs. If a parent cannot meet that parent's legal support obligation for his or her offspring, it is not in the best interest of society that said parent start up a new family which may require additional child support.

The staff notes that while such a scheme might ameliorate some of the problems in distinguishing separate and community property and tracing the source of particular assets, it would not accomplish this until after the passage of five and seven years, and thus would have very limited utility for solving prenuptial debt problems. The greatest impact of such a scheme would be upon debts incurred during marriage; this is discussed below under Section 5120.020.

Professor Bruch suggests that the Commission may wish to consider whether the separate property of the nondebtor spouse should also be liable for prenuptial debts immediately after exhaustion of the separate property of the debtor spouse and the community property, without the passage of seven years. This liability would parallel the personal liability of the nondebtor spouse for necessaries 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.

Order of satisfaction for 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 the community property and then out of separate property of the tortfeasor. Civil Code § 5122. The Commission tentatively recommended the repeal of this provision because it causes a number of difficulites. It requires a definition of what constitutes separate and community torts (and the staff is not aware of an adequate definition), 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, as well as other practical problems.

The staff believes it is futile to attempt to deal with the innumerable problems created by a scheme for an order of satisfaction against community and separate property. If any order of satisfaction is to be imposed, it should be accomplished through a reimbursement right between the spouses. The tentative recommendation to repeal the order of satisfaction for tort debts is sound.

Nonetheless, Professor Bruch at pages 23-29 of the management and control study argues that the tort order of satisfaction scheme of Civil Code Section 5122 should be preserved and implemented. Her argument is that an order of satisfaction 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 order of satisfaction 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 enforcment against certain assets or upon a motion for marshalling of assets.

The Commission heard the arguments of the staff and Professor Bruch in the fall of 1980 and tentatively decided to reinstate a tort order of satisfaction scheme, under a procedure comparable to the third-party claims procedure. Professors Bruch and Riesenfeld provided a preliminary draft of such a procedure (see Exhibit 8). They were requested to draft details for the procedure, and the Commission suggested a number of features, such as a debt that is part community and part separate is classified as all community, if property levied upon is part separate and part community, only the part primarily liable is applied to the debt, and the burden of proof is on persons other than the creditor.

We now have the comments of the State Bar Business Law Section (Exhibit 6). They believe the Commission's original recommendation to repeal the tort order of satisfaction provision (Civil Code § 5122) is correct:

It is the Section's belief that present § 5122 is superfluous and unnecessarily complicates the enforcement of judgments. There are numerous situations which could arise where a tort is not easily identifiable as a "separate" tort or a "community" tort. For example, consider an injury to an invitee on property which is a percentage community property with the remainder separate property. This situation is wholly unworkable under present § 5122 and burdensome for creditors.

Section 5122 has been enacted since 1975, and there have been no reported cases thereunder. It is the Section's belief that the Law Revision Commission's recommended repeal of § 5122 should be supported with a provision creating a right of reimbursement (within a limited time period) as between the spouses in both contract and tort cases.

On the other hand, Professor Bruch recommends at pages 38-39 of the management and control study that an order of satisfaction should be enacted for contract debts as well as tort 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 staff believes that 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. Such a characterization problem would invite continual litigation and would complicate the debt collection process greatly.

§ 5120.020. Liability of separate property

Section 5120.020 codifies the general California rule that the separate property of a spouse is not liable for debts of the other spouse but is liable for the spouse's own debts. June McGee (Exhibit 5) proposes implementation of the SCR concept (subject to creditors rights) to alter this rule. "After a reasonable period, e.g. seven years of marriage, both the community property and the separate property of either spouse should be SCR property, liable for all debts of either spouse incurred before or after marriage, with the exception of tort liability." The arguments for this proposal are: (1) If a debt benefits the marital community, both parties to the community are benefited, and both should be liable at some point in time. (2) The creditor's task of tracing origins of property to determine its liability would be simplified. (3) Increased liability would decrease the cost of credit and increase the availability of credit to both spouses.

Under this scheme, spousal agreements as to the characterization of property, e.g., separate or community property, would affect only the nature of the property as between the spouses; it would not affect its nature as SCR property. Thus an agreement between the spouses as to the characterization of the property would prevail at dissolution of marriage and at death. It is not clear under Ms. McGee's proposal what happens in probate as to creditors, and in particular whether joint tenancy property is subject to claims of the decedent's creditors.

§ 5120.030. Liability for necessaries

Subdivision (a)(1). Section 5120.030(a)(1) states the rule of existing law that the separate property of the nondebtor spouse is liable for the necessaries of life of the other spouse while the spouses are living together. Mr. Cornell (Exhibit 4) suggests that the separate property of the nondebtor spouse be liable only for the "common" necessaries of life. The Commission has previously rejected such a suggestion on the ground that spouses living together should be required to support one another in accordance with their station in life.

The State Bar Business Law Section (Exhibit 5) believes that the rule should be stated in terms of the liability of the nondebtor spouse rather than in terms of the liability of the separate property of the nondebtor spouse. The reason for this belief is that under Bankruptcy Code § 544(a), if separate property of the nondebtor spouse is liable for any debt of the debtor spouse, then all the separate property of the nondebtor spouse may be brought into the bankruptcy estate of the debtor spouse and shared by all creditors. But if the nondebtor spouse (as opposed to the separate property of the nondebtor spouse) is liable, the separate property could not be brought into bankruptcy and the necessaries creditor would still be able to pursue ordinary enforcement remedies to satisfy the debt. In essence, the State Bar Business Law Section recommends direct liability of both spouses for necessaries claims if the intent is to allow necessaries creditors to reach the separate property of the nondebtor spouse. The staff agrees that this would be a desirable change.

Subdivision (a)(2). The Commission has adopted a "common necessaries" test and rejected a "station in life" test in Section 5120.030(a)(2), which states the standard of libility where the spouses are living separate and apart. Mr. Avery (Exhibit 2) disagrees with this decision--

"It is basically unfair, for example, to an older woman, age 55, who has been out of the job market for 25 years to say the other spouse should only be liable for debts for common necessaries of life; he should maintain her accustomed style of life." Professor Bruch at pages 69-73 of the management and control study also urges that liability of the nondebtor spouse in this situation not be limited to common necessaries debts. She points out that such a limitation will hurt persons who have extended credit not knowing 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 necessaries expenditures.

The staff disagrees; it is one thing to subject separate property to liability where the spouses reside together and can make mutual decisions concerning their life style and attempt to limit their liability exposure, and quite another thing where the spouses reside separate and apart and have no control over the debt-incurring process. If one spouse desires greater support than for the common necessaries of life, the court mechanisms are available for obtaining support.

June McGee (Exhibit 5) suggests that the liability of the nondebtor spouse for debts incurred after separation be limited to two years. She offers no explanation for this suggestion.

The Executive Committee of the State Bar Family Law Section (Exhibit 3) is concerned with the interaction between the provisions governing liability for necessaries and the provisions permitting a spouse to obtain a court order for temporary support pending dissolution. The committee members fear that the liability provisions are "contrary to the family law act, would abrogate the legal procedure for obtaining support and would nullify any order entered."

The liability provisions proposed by the Commission are intended only to cover an informal separation and not intended to cover the situation where separation or dissolution proceedings are commenced and a support order is obtained. The staff believes that this should be made clear by revising Section 5120.030(a)(2) to provide that the separate property of a spouse is liable for a debt of the other spouse incurred during marriage if:

> (2) The debt was incurred for common necessaries of life of the other spouse while the spouses were living separate and apart, unless (A) the spouses were living separate and apart by a written

agreement that waived the obligation of support or (B) the debt was incurred while there was in effect a court order for support of the other spouse .

The State Bar Community Property Committee (South) appears to go beyond formal separation and take the position that a spouse should not be liable for the support of the other spouse during periods of informal separation. See Exhibit 7. They state that existing law cuts off such liability after separation "by agreement," although it is not clear what qualifies as an "agreement" when the spouses separate. Allowing a spouse to incur debts for which the other is liable is not only inequitable but may be a denial of due process; a separated spouse in need of support should be encouraged to apply to the court for relief. "The Commission's recommendation would encourage the supported spouse to incur debts with no apparent limitation imposed and no safeguards against using the device as an outlet for hostility."

Where there has been an informal separation of the parties, earnings of the parties are no longer community property but become the separate property of the separated spouses. Civil Code § 5118. Professor Bruch notes at pages 72-75 of the definition and division study that this rule can catch creditors without notice, since the parties have taken no legal steps to alter their relationship. But community property remains liable for any post-separation obligations incurred by either spouse. Civil Code §§ 5116, 5122; cf. Marriage of Hopkins, 74 Cal. App.3d 591, 141 Cal. Rptr. 597 (1977) (court may order spouse that incurred obligation to pay obligation). Professor Bruch recommends that Section 5118 be repealed, so that after an informal separation post-separation earnings remain liable for post-separation obligations until formal separation or dissolution occurs. Would such a rule require the working spouse to commence a marriage dissolution proceeding in order to limit this liability?

The State Bar Business Law Section (Exhibit 6) is concerned with a further problem that is not addressed by the statute: What is the obligation of community property (as opposed to the separate property of the nondebtor spouse) for debts incurred by a spouse after formal separation but prior to a final dissolution or property division? The State Bar proposes that post-separation debts be considered separate rather than community for purposes of creditors' rights. June McGee (Exhibit 5) takes this position also, noting that post-separation necessaries debts would remain community.

To implement this proposal, the State Bar recommends that post-separation creditors be allowed to reach only that portion of the community property that would have been awarded to the debtor spouse had division of the community property taken place as of the date of formal separation. "It is the feeling of the Section that a spouse, after formal separation, ought not to be put at risk for his or her one-half interest in the community property because of the business activities of the other spouse after separation. For example, if after separation a spouse engages in a business venture which proves to be disastrous, the other spouse's one-half interest in the community property should not be required to pay these post-separation debts."

This makes sense to the staff, but we do not know what constitutes a "formal separation" and we do not see how the suggestion for a partition of the community by a creditor could be implemented without substantial procedural problems. We are here concerned only with debts incurred after "formal separation." Perhaps the time of commencing the marriage dissolution proceeding should be the critical time and the creditor who has a judgment should be given a lien on the debtor spouse's one-half interest in the community property.

Subdivision (b). Section 5120.030(b) requires that in order for the separate property of a spouse to be liable for a necessaries debt of the other spouse, the spouse must be made a party to the judgment. The State Bar Business Law Section (Exhibit 6) believes this is an important clarification of the law. The Section also suggests we may wish to (1) add a provision to the effect that it is not necessary to join a spouse in order to satisfy a claim out of community property, and (2) more fully explain the manner in which to join a spouse. The staff agrees that both these suggestions are worth implementing. We would add the statement suggested in (1) to Section 5120.010 (liability of community property). The provisions suggested in (2) will be unnecessary if we adopt the State Bar proposal that the nondebtor spouse, as opposed to the separate property of the nondebtor spouse, is liable for necessaries debts.

Order of satisfaction. The existing law making the separate property of the nondebtor liable for necessaries debts does so only after community and quasi-community property have first been exhausted. This feature is not included in the tentative recommendation. If the Commission decides to pursue an order of satisfaction scheme and is able to

develop an adequate procedure, we will apply the procedure to necessaries debts as well. In doing so we will take into account problems raised by Professor Reppy concerning "quasi-community" property in such a scheme.

§ 5120.040. Interspousal transfers

The tentative recommendation states the rule that a transfer of property between the spouses is subject to the Uniform Fraudulent Conveyance Act; the Comment notes that this codifies existing law. The State Bar Business Law Section (Exhibit 6) opposes this provision: the law is clear without the provision and the provision creates an inference that other fraudulent conveyance statutes (such as Civil Code § 3440 and the bulk transfer laws) do not apply to interspousal transfers. The staff does not agree that the law is clear; we had to really hunt to find the cases we cited, and even those cases are not really good solid holdings on point. As to creating an inference that other fraudulent conveyance statutes do not apply, we can easily add a sentence to the statute to negate any such inference or rephrase the statute so that such an inference is not created.

Mr. Avery (Exhibit 2) favors transmutation of property by interspousal transfer but believes that it is socially necessary and desirable to place some limitations on transmutations, such as a requirement that they be in writing. "This would certainly clarify what is now a troublesome area and it would probably also contribute greatly to certainty in the field of income, estate and gift taxation." This is also the position of the State Bar Debtor/Creditor Committee, conveyed to the Commission in connection with the Commission's work on Civil Code Section 3440. The Commission has decided not to amend Section 3440 but to work on the problems of marital transmutations and agreements and to give the work some priority. See Memorandum 82-3 (community property--determination of priorities).

Professor Reppy also points out the difficulties easy transmutation causes for creditors and recommends that if the transmutation is to bind creditors, apart from its effect as between the spouses, it may be desirable to change the statutes to require both a writing and recordation. June McGee (Exhibit 5) goes even farther and proposes that transmutation should have no effect at all on creditors (even if in writing and recorded); the property remains subject to creditors' rights (SCR):

> Clearly, the parties have every right to dispose of their property as they see fit, but they should not be allowed to confuse or defeat the reasonable expectations of their creditors thereby. Thus, even if earnings of one spouse are made the separate property of the other spouse by gift or agreement, as to the creditors, said earnings should be SCR property, subject to the rights of indemnification between the spouses according to their agreement. The Fraudulent Conveyance Act is too easily defeated; fraud is too difficult to prove, and the legal proceedings involved in challenging such transfers are too uncertain and costly. What is community property and what is separate property should be clearly and legally defined. Exceptions to these definitions by agreement of spouse should be binding between the spouses but not on creditors' rights.

The Commission has 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 of the management and control study 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. In any case, the Commission must now make a decision whether to continue for the present to permit easy transmutation, at least as it affects creditors, if not for relations between the spouses. This decision would be reviewed when the subject of transmutation generally is considered.

§ 5120.050. Liability of property after division

At dissolution of marriage the community property is divided and debts are assigned for payment between the spouses. Under existing law

if a creditor is not paid by the spouse to whom the debt was assigned, the creditor can reach property of either spouse that was formerly community property, including property of a nondebtor spouse to whom the debt was not assigned, on the basis that the creditor's rights are traceable to the property that was liable before dissolution and should remain liable after.

Subdivision (a)(1). Section 5120.050(a)(1) of the tentative recommendation provides that the spouse who incurred a debt remains personally liable on the debt even if assigned to the other spouse for payment (reimbursement rights are provided). The State Bar Business Law Section (Exhibit 6) believes this is an important clarification of the law.

Subdivision (a)(2). Section 5120.050(a)(2) of the tentative recommendation repeals the rule that a creditor may reach former community property awarded to a nondebtor spouse who was not assigned the debt. June McGee (Exhibit 5) believes that existing law is fair and should not be changed. The State Bar Business Law Section (Exhibit 6) notes that it is necessary to allow a creditor to reach the former community property because creditors are not paid in the dissolution proceeding and are not assured payment by the award of property to the spouse to whom the debt is assigned.

However, the State Bar Business Law Section also believes that the existing rule needs to be narrowed, since former community property could be held accountable when default on a long-term obligation occurs years after dissolution. The Section recommends a modified fraudulent conveyance provision that would limit the ability of the creditor to go against former community property to instances where, after eliminating exempt assets, the assets divided are insufficient to pay the debts assigned to a particular spouse:

> In such cases, creditors should be given three years to bring suit against the other spouse's community property award. (Identical to Fraudulent Conveyance Law). However, under circumstances where the spouses are each solvent after division (on the modified solvency test which excludes exempt assets), the division would be final and the spouses would be free to pursue their own lives without interference from the other spouse's pre-separation creditors at some later date. Creditors are adequately protected by this proposal, for even in marriage the spouses could have given away their property if they remained solvent after the gift. The Section believes its proposal is a highly desirable clarification and improvement in existing law which limits the attack to standard fraudulent conveyance doctrine.

Such a scheme sounds like a reasonable compromise position, but the staff is not certain how it would work mechanically. Assume, for example, that the spouses are not solvent and that creditors have three years in which to bring suit. May they sue even if the debt will not be due for four years (i.e., there has not yet been a breach of the obligation)? If the debt does come due during the three-year period, how is the creditor to receive notice that there has been a dissolution and that the creditor must take action before expiration of the three-year period or lose the right to go against the former community property?

Professor Bruch at pages 124-128 of the division study also suggests that a fraudulent conveyance type system be used. Under her proposal a creditor could look only to the property of the spouse to whom the debt was assigned, and could not look to any property of the other spouse even if the other spouse originally incurred the debt, unless the creditor could show a fraudulent conveyance. "Provisions for notifying and binding creditors to such nonfraudulent agreements should be patterned after those now in use as to pension plans and the division of pensions. Creditors would thereby become parties to the adjudication and bound by it, except that they would remain free to litigate questions of fraudulent conveyance."

Subdivision (a)(3). Section 5120.050(a)(3) of the tentative recommendation expands the liability of the spouse to whom the debt was assigned--all the property of the spouse, not just the former community property, is liable for the debt. The State Bar Family Law Executive Committee (Exhibit 3) favors the proposal to widen the liability of a party assigned a debt. Mr. Avery (Exhibit 2) agrees.

Mr. Avery also feels that the best way to deal with the problem is to treat dissolution in the same manner as a probate proceeding, with notice to creditors, presentation of claims, and payment of the debt or assignment to one party or the other or both, which would bind creditors. The staff believes this idea has some merit; however, in practice it could turn a relatively simple dissolution into a major production. The Commission has discussed this idea before and rejected it.

Subdivision (b). Section 5120.050(b) provides a reimbursement right, with interest and a reasonable attorney's fee, where a debt is satisfied out of property of the spouse to whom the debt was not assigned. The State Bar Family Law Executive Committee favors this proposal. Exhibit 3.

Civil Code § 4800

As a part of the tentative recommendation on liability of property after dissolution, the Commission proposed that upon dissolution the allocation of debts to the spouses should take into consideration the rights of creditors and the debts should be divided in a "just and equitable" manner. The intent of this proposal was to permit the court to assign debts in such a way that the person to whom a debt is assigned has sufficient assets to be able to pay the debt. This may result in an unequal division of the community property.

Professor Bruch, at pages 39-40 of the management and control study, 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.

The proposal for unequal division was opposed by the State Bar Family Law Executive Committee (Exhibit 3) because it allows or favors an unequal division and could be interpreted as allowing an award of debts based on fault, which would be a retrogression to pre-1970 status. "We see this proposal as a return to the ways of the past. The house to the wife, the business and the debts to the husband. It has been a long battle to convince the trial court that equal division meant equal and

that the marital community could not be divided without valuing the assets." A similar view was stated by Mr. Cornell (Exhibit 4), who noted the tendency of the courts to find amendments such as the one proposed to be a directive for less than an equal division of property. He suggests that the amendment be revised to emphasize that the division is one that "takes into account the distribution of both the assets and the obligations and divides the net result equally." The State Bar Community Property Committee (South) also opposed the listing of factors for assignment of debts as ambiguous and unnecessary. See Exhibit 7.

The staff agrees with these comments. Our objective here should be to help assure payment to the creditor following dissolution of marriage, rather than to encourage or even permit an unequal division of assets. Our commentators point out that the court has authority to take into account the rights of creditors in assigning debts to the spouses absent any amendment to Civil Code Section 4800. However, in Section 5120.050, we preclude the creditor from reaching former community property after dissolution, so we do need specific language directing the court to consider the rights of creditors in assigning the debts. The staff suggests the following language:

> (5) In dividing the debts the court shall take into consideration such factors as the earning capacity of, and the exempt character of property received by, the party to whom a debt is assigned so as to protect the rights of creditors to the extent practical, provided the division of the property is equal.
>
> Comment. Paragraph (5) is added to Section 4800(b) to make clear the court's discretion to allocate debts in a way that will protect the rights of creditors. However, the division of debts must be made in such a manner that the totals of the assets awarded to the parties after deduction of the obligations allocated to the parties are equal. See, e.g., In re Marriage of Fonstein, 17 Cal.3d 738, 552 P.2d 1169, 131 Cal. Rptr. 873 (1976) (equal division required); In re Marriage of Eastis, 47 Cal. App.3d 459, 120 Cal. Rptr. 86 (1975) (unequal division in "bankrupt family" situation); In re Marriage of Schultz, 105 Cal. App.3d 846, ___ Cal. Rptr. ___ (1980) (court has no discretion to adjust the division of the residual assets to reflect equitable considerations).

A related problem is the extent to which "separate" and "community" debts should be distinguished at dissolution, with the separate debts assigned to the person who incurred them and the community debts divided. This problem is really distinct, and we will deal with it separately in connection with dissolution. It is discussed in Professor Bruch's division study at pages 98-101 and 123-124.

§ 5120.060. Liability of property after judgment of nullity

Mr. Avery (Exhibit 2) disagrees with the Commission's proposal to allow a creditor the same rights against property of an annulled marriage as against property of a valid marriage. "Your proposal has the effect of making the property of the couple community property for debt payment purposes even if the marriage is bigamous or if it is annulled on the basis of fraud." The staff does not feel strongly about this point; the reason for the provision is to clarify the law in an area that is now unclear, and it could be clarified either for or against liability of the property of the "spouses." The Commission has recommended in favor of liability of the property of the "spouses" because the couple has held themselves out as being married and third-party creditors may well have acted in reliance.

June McGee (Exhibit 5) agrees that the statute should provide that creditors' rights are the same as against property of a valid marriage that ended in dissolution. "These parties held themselves out as being married, . . . and third party creditors should be entitled to rely on such representations without detriment."

Article 2. Reimbursement

Where a "community" debt is satisfied out of the separate property of a spouse, should the spouse be entitled to reimbursement from the community? Where a "separate" debt of a spouse is satisfied out of the community property, should the community be entitled to reimbursement from the spouse? If so, when and how? These questions are ones the Commission has reserved until now.

Mr. Cornell (Exhibit 4) believes that reimbursement rights should be codified, "both as between parties and from the community." Mr. Avery (Exhibit 2) believes it would be better simply to require separate creditors to go after separate property and community creditors to go after community property. "However, if the concept of priorities is rejected, then I would support reimbursement as a concept to protect the innocent spouse (i.e., non debt-incurring spouse)." The State Bar Business Law Section (Exhibit 6) believes the existing provision for an order of satisfaction of tort debts should be repealed and replaced by a provision creating a right of reimbursement (within a limited time period) as between the spouses in both contract and tort cases.

Professor Bruch advocates a dual approach to reimbursement. See pages 92-97 of the management and control study. 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 some concern about the advisability of permitting interspousal litigation for reimbursement during marriage. 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 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 dissolution proceeding anyway. And suppose one spouse recovers judgment against the other spouse; how will the judgment be enforced? If the 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 questions the wisdom of embarking on this path.

On the other hand, allowing reimbursement at the time of dissolution also creates problems. It permits 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 arise in sorting and tracing property and obligations over a marriage of any length can 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.

Article 3. Transition Provisions

The Commission's tentative recommendation did not include any transition provisions since none of the proposals were of a nature that would require transition provisions. If the Commission decides to recommend that transmutations be in writing or to provide for reimbursement rights, transition provisions should be adopted as part of the proposals. Otherwise, the staff suggests only one transition provision:

> § 5120.310. Enforcement of debts
>
> 5120.310. Except as otherwise provided by statute, the provisions of this chapter govern the liability of separate and community property for a debt enforced on or after the operative date of this chapter, regardless whether the debt was incurred before, on, or after the operative date.
>
> Comment. Section 5120.310 states the general rule that this chapter applies immediately to all debts regardless of the time they were incurred. (For exceptions to the general rule, see Sections _____.)

Civil Code § 5123

Mr. Avery (Exhibit 2) objects to the proposed repeal of Section 5123, which immunizes separate property of a spouse from liability for a debt secured by community property unless the spouse consents in writing to the liability. Mr. Avery offers no reasons for the objection other than that the Commission does not offer reasons for the repeal. In fact, the Commission does offer reasons for the repeal at page 9 of the tentative recommendation, but the reasons are somewhat succinctly stated. The staff recommends that the discussion of Section 5123 be expanded along the following lines:

This provision is peculiar in protecting separate property of a spouse in the event of a deficiency but not other community property. It is thus inconsistent not only with general rules governing deficiency judgments,[31] but also with general rules governing liability of property of a married person obligated on a debt.[32] Section 5123 was enacted at a time when the separate property of a married woman was not ordinarily liable for a debt; this is no longer the law. The historical reasons that led to its enactment are now obsolete,[33] and the section should be repealed.

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31. See, e.g., Code Civ. Proc. §§ 580a, 580b.
32. See, e.g., Civil Code § 5121 (liability of separate property of spouse).
33. See study at pp. 60-62.

The State Bar Business Law Section (Exhibit 6) questions the repeal of Section 5123 for a different reason. They point out that the separate property of a spouse should not be liable for a debt secured by community property unless the spouse incurred the debt. The staff believes this is a good point; it is consistent with the rest of the policy decisions the Commission has made in this area. In place of the repealed Section 5123 the staff would enact a provision to make clear that, "The separate property of a spouse is not liable for a debt, whether or not the spouse has joined in the encumbrance of property to secure the payment of the debt, unless the spouse is personally liable for debt."

Civil Code § 5131

Section 5131 states the general support obligation of spouses while living separate from each other by agreement--they are not liable for support unless the support is stipulated in the agreement. The Commission has proposed to alter one aspect of this rule, making the separate property of a spouse liable for necessaries debts of the other spouse unless the support obligation is expressly waived. Mr. Cornell (Exhibit 4) believes the Commission's recommendation is sound but that the Commission should go the rest of the way and repeal Section 5131 outright. This would go beyond the scope of the present recommendation, as Mr. Cornell recognizes, which deals only with creditors' remedies and not rights of spouses as between each other.

Civil Code § 5132

Section 5132 provides that a spouse must support the other spouse while they are living together out of separate property if there is no

community or quasi-community property. The tentative recommendation amends this section to recognize that under proposed Section 5120.030 a necessaries creditor can reach the separate property without having first to exhaust the community and quasi-community property. The State Bar Family Law Executive Committee (Exhibit 3) feels that the amendment to Section 5132 is unnecessary and confusing. The staff agrees that it is somewhat confusing, but we believe that it is necessary to alert people to the interrelation of Sections 5132 and 5120.030. The staff would replace the proposed amendment to Section 5132 with a simple prefatory "Subject to Section 5120.030, ..."

Fruits of Separate Property

Professor Bruch at pages 35-42 of the division study recommends that the fruits of separate property (rents, issues, and profits, including natural appreciation) be treated as community. June McGee (Exhibit 5) makes the same suggestion, at least with regard to creditors' rights. This would be a major change in the law with major implications for the community property system. The staff believes it would be inadvisable to deal with it at this time; we will schedule a separate memorandum that explores this idea in depth, at a time consistent with the Commission's determination of priorities on the community property study.

Liability of Unmarried Cohabitants

June McGee (Exhibit 5) proposes that where unmarried persons have a cohabitation living arrangement that endures five years or longer, the income of the persons should be treated as community property. "To exempt the income of partners to living arrangements from the debts of their long-term cohabitants is to penalize those who do make conventional commitments and enter into valid marriage agreements. Further, in most cases both partners benefit from the income and living standards of the other, and should, therefore, share the risks and liabilities as well as the benefits of combined incomes." Professor Reppy at pages 218-221 of the debt collection study also discusses the possibility of making property of cohabitants liable for each other's debts on express or implied contract theories.

The Commission in the past has decided not to get involved in this area. The attempt to define by statute when two persons are "cohabiting" so as to allow creditors to reach their property seems destined to create nothing but more problems. And even if a satisfactory and politi-

cally feasible definition were achieved, it appears impossible to apply it in practice. The fact that the courts wish to pursue this avenue is no reason the Legislature should try to make sense out of the pursuit.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

STATE OF CALIFORNIA
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ROBERT KINGSLEY
ASSOCIATE JUSTICE

July 15, 1980

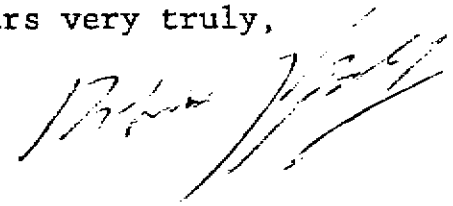
John H. DeMoully, Esq.,
Executive Secretary,
California Law Revision Commission,
4000 Middlefield Road, Room D-2,
Palo Alto, California 94306

My dear Mr. Secretary:

I comment, at this time, on only one aspect of your Tentative Recommendation Relating To Liability Of Marital Property For Debts.

I have long thought that former section 5120 of the Civil Code, which you propose to carry forward in a modified form in Subdivision (b) of your section 5120.010, was bad policy. In the words of the usual marriage ceremony, one takes a spouse "for richer or poorer, for better or worse." Marriage should not be a substitute for bankruptcy. But the rule exempting the "earnings" of a spouse for premarital debts of his new spouse operates exactly that way. A person (more usually but not necessarily a woman) incurs debts she (or he) prefers not to pay. She (or he) discovers a prospective spouse with good earning capacity but no substantial savings, marries, and thumbs her (or his) nose at the creditors. Neither good policy nor common sense can support such a system. I would abolish the rule in its entirety.

Yours very truly,



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July 27, 1980

OUR FILE NUMBER

9911.46-4A(1)

John H. DeMoully, Executive Secretary
The California Law Revision Commission
4000 Middlefield Road, Room D-2
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LIABILITY OF MARITAL PROPERTY FOR DEBTS

Dear Mr. DeMoully:

This will follow up on your memo of June 26, 1980. I believe the two areas not covered, (1) exemption and (2) reimbursement of spouses are important and need study.

I would appreciate receiving a copy of Reppy, Debt Collection From Married Persons in California (1980).

In the June, 1980 report "Liability of Marital Property for Debts" and the discussion of the California system, there is an assumption I believe is in error. I do not agree that the system is "most sound in theory and practice" as the report claims. The report at page 2 blithely assumes that spouses have "equal management and control." Equal management and control is a legal fiction. In fact, most community debts are incurred by one spouse without consent or consultation with the other (except, for example, a home where the financial institution insists on the joint signature). Moreover, there is serious question from a standpoint of social policy whether creditors should be protected as they presently are under the law. In my opinion, it might be more equitable among spouses to revise the law to provide that both community and separate property are treated the same. The property is only available to creditors of the spouse incurring the debt and only to the limit of that spouse's assets.

California adopted a "fiction" when it legislated joint management of community property. For most marriages, debts incurred are more important as an economic fact than assets acquired. The law is written and assumes there will be joint management but that does not happen. One spouse usually manages most of the community property (in the traditional family relationship where one spouse works) or each spouse manages his or her community property (where both spouses work). I would recommend consideration of a rule of law that says the community property of one spouse is not liable for debts incurred by the other spouse without the written consent of the first spouse except in the case of "necessities".

I would also urge clarification of the law to establish a priority that separate property of the spouse who incurred a debt must be utilized first and only if that separate property is insufficient should there be a right to a charging lien on the community property (that is against the half of the community property belonging to the debt incurring spouse who did not obtain consent of the other spouse in writing). Too often in a marriage debts are incurred by one spouse without the consent of the other spouse (usually the "innocent spouse" who tried to control spendthrift habits of an inprudent spouse but has no ability because his or her signature is not required when that spendthrift spouse buys clothes, furniture, autos, and luxuries that the community cannot afford. The restraint on granting credit caused by requiring the signatures of both spouses would, I believe, eventually lead to a decline in personal bankruptcies and a decline in all of the other personal tragedies arising out of too liberal of granting credit.

I believe the report is correct in its appraisal at page 4 of the difficulty of determining what is separate or what is community. However, if the law were what I advocate, in my opinion, much of the uncertainty would be removed because credit grantors would uniformly seek and obtain joint signatures.

I disagree with the Commission's conclusion on page 5 that improving the rights of creditors or strengthening the rights of creditors is the best solution. Most debtor-creditor disputes take place below the level of court action and to strengthen the bargaining position of creditors is not in the best interest of society. The adoption of a reimbursement right between spouses is not the correct solution. I believe the solution should be to establish priorities as I have advocated. However, if the concept of priorities is rejected, then I would support reimbursement as a concept to protect the innocent spouse (i.e., non debt-incurring spouse).

I am not in agreement with the conclusion on page 6 that the community property should automatically be liable for prenuptial

debts. When persons marry, they frequently do not exchange economic information, particularly as to the extent of their debts. Great unfairness has been worked on debt-free persons who marry improvident persons. The rule that the community property becomes liable for the prenuptial debts works an added hardship on a new marriage and contributes to martial discord. This is particularly true where the debtor spouse is not earning the community income and the earnings of the innocent earning spouse are partially available to prior creditors. I would favor the opposite rule; a rule that would say that community property is not available to prenuptial creditors until all separate property is exhausted and possibly also until two years after marriage.

Without such a time protection, the law encourages non-married cohabitation. It is better to live together and not have earnings subject to pre-cohabitation debt then it is to marry and subject community property earnings to separate debt.

I disagree with the recommendations on page 7 relating to the handling of debts for necessities after separation. I believe you have overlooked the present increase in separations where the parties have been married 25 or 30 years and children reared and a dependent spouse is dumped because the supporting spouse goes through some emotional or physiological change and wants a drastic life style change. It is basically unfair, for example, to an older woman, age 55, who has been out of the job market for 25 years to say the other spouse should only be liable for debts for common necessities of life; he should maintain her accustomed style of life.

I agree with the conclusion at the top of page 8 about joinder of a non-debtor spouse.

While transmutation of property by interspousal transfers is something I favor, I believe it is socially necessary and desirable to tighten up the law in this area. Therefore, I would urge a requirement that such transmutation be in writing. This would certainly clarify what is now a troublesome area and it would probably also contribute greatly to certainty in the field of income, estate and gift taxation.

On page 9, I see a discussion of the Anti-Deficiency Protection of Separate Property and a recommendation for repeal based on the fact the law arose "for historical reasons." There is no social justification for repeal and for historical reasons (i.e., stability of the law), I would recommend retention of the present law.

On page 9, the study discusses division of debts as if it were easy or an area of certainty. In the case of separation, the

usual practice is that both spouses remain liable and the "responsible" spouse (not necessarily the debt incurring spouse) pays the debts. In the case of dissolution of marriage, the allocation of debts is frequently erroneously ignored or lately has been the subject of extensive litigation because of its effect upon property rights of spouses who have contributed separate property for payment of community debts. In my opinion, the liability after division of property should be handled like a probate proceeding.

If there is to be a dissoluton of marriage, there would be a notice to creditors and the non-debt incurring spouse would be absolved from the debts other than those he or she incurred if the creditors did not come to court for a determination of their rights and a determination of what property was available to creditors.

Many marriages break up over mismanagement of finances. It is socially undesirable to continue the burden of the marriage on an innocent spouse who seeks to dissolve the marriage but remains saddled with the "community debts". He or she should be bound by debts specifically assumed but not by debts incurred by the other spouse. The cause of action for reimbursement from the other spouse is probably socially desirable to protect the innocent spouse, but it is no relief and no solutin to the problem of a spouse trying to escape the debts of the other spouse.

The solution on page 10 that a creditor should only be permitted to pursue the person to whom the debt is assigned at the time of dissolution is a good one, but does it not take away rights of the creditor? Moreover, I doubt that it is constitutionally sound unless the creditor is given the right to intervene in the dissolution proceedings to obtain a determination of which spouse will be liable for the debt. Otherwise, marital dissolution could be a way of informally eliminating creditors by assigning debts to an impecunious spouse.

I do not understand why the law should be that creditors should have the same rights against property of an annulled marriage. If my proposal requiring that both spouses sign or only the signing spouse's assets are liable were adopted, the problem would take care of itself. If the marriage is annulled, the creditor has recourse only to the assets of the debt incurring spouse.

Your proposal has the effect of making the property of the couple community property for debt payment purposes even if the marriage is bigamous or if it is annulled on the basis of fraud.

The law of exemptions is one that needs reexamination, particularly the law relating to probate homesteads. Here the problems

include not only the ability to defeat creditors, but also the problem of defeating the will of the decedent even where one spouse dies while a martial dissolution is in process.

On reviewing my letter, I see that I disagree with many of the study conclusions. My disagreement is mainly based upon my perceptions of reality as a practicing lawyer. I do not know if many other lawyers would agree with you either. As an idea, I suggest you submit the study to the California State Bar Section of Family Law and ask its chairperson to have a group of family law specialists analyze the study and give the Commission a practical appraisal.

Yours sincerely,

Luther J. Avery

LJA:ble(2745b)

cc: William Cantwell
Prof. Mary Wenig

EXHIBIT 3

SANDRA G. MUSSER
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(415) 885-4747

August 11, 1980

John H. DeMoully
Executive Secretary
California Law Revision Commission
4000 Middlefield Road, Room D-2
Palo Alto, CA. 94306

Re: Tentative Recommendation re Liability of Marital Property for Debts

Dear Mr. DeMoully:

I am replying on behalf of the Executive Committee of the Family Law section of the State Bar. Because our standing committees meet infrequently if at all during July and August our reply is more cursory than we would like.

Because our review of the proposals was not thorough I would like only to point out and discuss those proposals which we felt would be detrimental to the efficient practice of marital law and/or undesirable and give our reasons.

1. The proposal to extend liability to a spouse for necessaries obligations incurred following separation is contrary to the family law act, would abrogate the legal procedure for obtaining support and would nullify any order entered. In my opinion this proposal would increase litigation, create uncertainty and place a premium on avoiding pendente lite support awards.

Under the present state of the law, each party is responsible for the obligations he incurs after separation. In re Marriage of Hopkins.

If a spouse is in need of support he or she may apply to the court for support pendente lite by noticed motion after a response is on file or by order to show cause prior thereto. Under extreme circumstances the court may ex parte prior to the order to show cause award support.

In our opinion under your proposal the following would and/or could occur.

a. There would be no purpose in seeking an order to show cause. The non-working spouse could merely charge groceries, clothing, medical care, furniture and housing as desired or invade community assets for the payment of these obligations. This places a premium on spending freely at a time when families can least afford it and gives the non-working spouse an advantage.

The employed spouse would by law be responsible for the fill. The amounts charged might well exceed the amount the court would award pendente lite. Similarly if the non-earning spouse has invaded the community the wage earner has no recourse and no right of reimbursement.

b. A pendente lite award is entered. The non-working spouse believing the award insufficient spends the support on non-necessary items and charges the necessaries, i.e. groceries, medical care, clothing and/or fails to pay the mortgage. The earning spouse is legally responsible and must pay these bills as well as the pendente lite support.

Several years ago the law required the payment of necessaries obligations incurred during separation by the wage earning spouse on behalf of the non-earning spouse. My understanding is that both of the above scenarios were common problems.

We believe that certainty and order are of primary importance in a dissolution action. The parties should be encouraged to work out written pendente lite agreements or seek a court order. Any change in the law which would encourage avoidance of the pendente lite hearing and/or order and/or make it uncertain will open the door to abuse, increase litigation and will delay the ultimate resolution of the marital dissolution.

We can think of almost no situation where a party in need of necessaries could not obtain a pendente lite award.

2. We are opposed to the amendment of section 4800 as proposed.

In our experience the court almost always does consider the earning capacity of the parties and the rights of creditors.

This amendment is dangerous because it appears to allow or favor an unequal division of the assets and could be interpreted as allowing an award of debts based on fault.

Presently the law requires an equal division of community estates with a positive value. Where the debts exceed the assets the court may award the excess debts to one spouse.

As this proposal is written the Court could award the house to the Wife and the mortgage thereon to the Husband - a retrogression to pre-1970 status when we had fault decrees. See for example In re Marriage of Chala.

The committee is particularly sensative to the potential for unequal division which creates a greater potential for abuse. Recently there is case law allowing a wife with children to remain in the home for a number of years and proposed legislation to change pensions to non-community property - all tending towards unequal division.

We see this proposal as a return to the ways of the past. The house to the wife, the business and the debts to the husband. It has been a long battle to convince the trial court that equal division meant equal and that the marital community could not be divided without valuing the assets.

3. In conjunction with our comments on Necessaries we feel section 5132(a)(2) is unnecessary and confusing.

We favored your proposals regarding attorneys fees on actions regarding reimbursement, widening the liability of a party assigned a debt and removing the distinction between liability for and/or contract obligations.

We feel that the area of debts and community property and marital dissolution is one which needs a thorough examination and new legislation. If it is not too late in the process we would like to have a member of our standing committee keep in contact with you and perhaps make some proposals we feel would assist in clarifying this difficult and unclear area.

Very truly yours,

Sandra G. Musser

SGM:ry

EXHIBIT 4

LAW OFFICES OF

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REPLY TO: Merced

August 15, 1980

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

Re: Law relating to liability of marital property for debts

Gentlemen:

I have reviewed the tentative recommendation relating to the liability of marital property, and I have the following comments to make:

1. Your amendment to Section 4800 (b) (5) is probably unnecessary as there is no method to require the Judge to make a specific allocation of an obligation to a specific party. Moreover, the tendancy of the Courts to find such amendments to be a directive for less than an equal division of property is very great. When the enactment of (b) (4) (educational loans) was made, a great many Judges assumed that that meant that the educational loans were not to be considered in the ultimate disposition of community property and obligations. In other words, the Court would make a "net" equal distribution to the parties by excluding the educational loans, and then would assign the educational loans to the person who received the education. The result would be less than an equal division. Accordingly, if subdivision (b) (5) is to be enacted, I suggest that it be reworded to emphasize that the equal division set forth in 4800 (a) be a "net equal division" which takes into account the distribution of both the assets and the obligations and divides the net result equally.

2. The entire work you are promoting should include an effort to codify the holding of the Supreme Court in In re marriage of Epstein. You make statements that you are considering the issue of reimbursement, and it appears that now is the time to do so, both as

between parties and from the community. You do specify the right to reimbursement at one portion of your tentative recommendation, Section 5120.050 (b).

3. Section 5120.030 (a) (1) should be amended to provide for the word "common" before necessaries of life. Such an amendment would be consistent with the rest of the act, and with the case law that deals with the subject.

I agree with the general trend of the rest of the proposal, and I feel the creditors will be more likely to advance credit to the woman who has been forced to leave the home if your proposals are adopted. However, although it may not be within the perameters of your review, I feel that Section 5131 of the Civil Code as presently constituted is antiquated and should be repealed. If attorneys chose to enforce the technical language of 5131, and Judges followed the technical language, havoc could be recked upon spouses who were forced to agree to leave the residence by their counterparts. The amendments that you provide in Section 5120.030 go along way to eliminate the effect of 5131, so there does not appear to be any reason to have the law on the books anymore.

Thank you for the opportunity to comment on your proposals.

Very truly yours,

ALLEN, IVEY, CORNELL, MASON & CASTELLUCCI

By Dennis A. Cornell

DENNIS A. CORNELL

DAC:kej

EXHIBIT 5

COMMUNITY PROPERTY AND CREDITORS' RIGHTS

Prepared By: June McGee
April 20, 1981

A. INTRODUCTION:

The problems of determining rights and obligations between creditor and spouses who reside in community property states are complicated by the fact that courts and legislators tend to become emotional when considering what is separate property, what is community property, and what can be attached, levied and executed on by a creditor. The confusion stems from two distinct interests that come into play, those of the husband vs. the wife and those of the spouses vs. the creditor. By designating the legal character of property as separate or community, one determines its liability for debts and its disposition upon dissolution of the marriage or death of the parties. Basically, this is the ages-old property division argument between spouses.

Creditors dealing with married persons would prefer not to be concerned about ultimate disposition. Their main objective is certainty of collateral and maximum protection of collateral with minimum procedural burdens. The creditor does not want the burden, nor the expense, of tracing origins of spousal property to determine whether it is community property or the separate property of a spouse and, therefore, possibly not subject to liability.

Simply put, the creditor favors the argument that if a debt benefits the marital community, both parties to the community are benefited, and both should be liable at some point in time; that is, both their separate and their community property should be liable. This position is equally to the advantage of the consumer, because by simplifying the creditor's task of tracing origins of property to determine its liability, one eliminates costs of credit, presently passed on to the consumer, and also increases the availability of such credit to both spouses.

Although considerable progress has been made in updating[1] California's commun-

[1] Especially the 1973 Amendments, effective January 1, 1975.

ity property laws to establish a uniform approach to community property for both spouses, many concepts still in practice reflect the historic concern that the wife's interests, being those of the non-earning, non-managing spouse, required particular protection from the courts. These laws have yet to be updated to reflect the changing life styles of today's society where the majority of married women are employed and contributing to the family income. Also, the courts are now moving in the direction of looking through form to substance and treating couples who cohabit for a period of time as having agreed to a social contract with rights between themselves somewhat different from the marriage contract, but as far as property rights and debts are concerned, who present the same community interests and credit problems as those of a married couple. This evolution in legal thinking is slowly and gradually underway and much remains to be decided.

Presently tentative recommendations have been made by the State of California Law Revision Commission relating to liability of marital property for debts of the marital community. Bankers and other lenders and creditors have an interest in assisting in the systematic evolution of these laws and in developing an approach that is equitable and fair to creditors as well as to the marital parties.

B. GUIDELINES FOR REVISION:

In line with the above, the following concepts are suggested as goals and guidelines for revision of the California community property laws at this time:

1.) Community property should be liable for debts of either spouse after marriage without regard to who has management and control,[2] including bank accounts in the name of one spouse.[3]

2.) Liability for debts of either spouse incurred, contractually or otherwise, before marriage should become the liability of all the community property (including earnings of other spouse) after a reasonable time interval, e.g. 5 years after marriage.

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[2]Proposed by Law California Law Revision Commission, June 1980.

[3]See Financial Code Section 851.

3.) From the time of marriage, all income from either spouse's separate property should be property "subject to creditor's rights", herein called "SCR property," a special form of community property.

4.) After a reasonable period, e.g. seven years of marriage, both the community property and the separate property of either spouse should be SCR property, liable for all debts of either spouse incurred before or after marriage, with the exception of tort liability.

5.) After seven years of cohabitation, both the separate property and what would in a proper marriage be characterized as community property of either party to a non-marital living arrangement should be SCR property, liable for all debts of either party incurred during the period of cohabitation. After five years of cohabitation, creditors' rights against property of these arrangements should be treated the same as property of a conventional marriage.

6.) Spousal agreements as to what should be the characterization of property, e.g. separate property or community property, should affect the property's characterization, between the spouses, but not its characterization as to creditors, SCR property. Thus, the characterizations, separate property and community property, should prevail at the times of dissolution, will-making, death, probate, intestacy, but spousal agreements should confer rights of indemnification between the parties.

7.) Separate property of a non-debtor spouse should be liable for necessaries' debts of the other spouse incurred after separation, unless liability is expressly waived in the separation agreement, for a period of two years after separation.

8.) Characterization of property as SCR property, as to debts incurred during marriage, should continue until determination by the court as to disposition of debts, e.g. dissolution, probate proceedings, etc. Except for necessaries' debts, all spousal debts incurred after separation would be their separate debts.

C. PROBLEMS IN PRESENT COMMUNITY PROPERTY LAW:

1.) Premarital Debts:

Present California law holds that "the earnings of a spouse after marriage are not liable for the contracts of the other spouse contracted before marriage.[4]"

The wording of this statute, particularly the use of the word "contracts" has been taken to mean that the law implies a different rule for prenuptial tort debts, and other non-contractual debts, namely that said debts may be satisfied from the earnings of the non-debtor spouse after marriage.[5] This language requires clarification.

As to how long the earnings of the non-debtor spouse should remain not liable for a prenuptial debt of the debtor spouse, the Commission "recommends that the earnings should lose their protection from liability upon a change in form, but that they should retain their protection so long as traceable in bank accounts. This will ensure that substantial amounts of community property are not immunized from creditors, that the judicial system is not burdened by extensive tracing requirements, and that earnings will remain exempt so long as they retain their peculiarly personal character."[6]

The proposal put forth herein, (point 2 above), namely that all the community property including earnings of the other spouse should be liable for pre-marital debts after five years of marriage, would both clarify and simplify the law. No tracing or determination of a change in form for earnings of the non-debtor spouse would be necessary after five years. The separate property of the debtor spouse and all community

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[4]Civil Code Section 5120.

[5]See California Law Revision Commission, TENTATIVE RECOMMENDATIONS, June, 1980, page 6.

[6]See California Law Revision Commission, June 1980, page 6.

property of both spouses, including earnings of the other spouse would be liable for the pre-marital debt, torts included according to priority. After seven years of marriage, (point 4), any pre-marital debts left unpaid would be collateralized by the total resources, separate property included, of both partners to the marriage.

Arguments as to the equities involved in making separate property liable for pre-marital debts after seven years are countered by the fact that most pre-marital debts are paid off by that time. If there were support obligations for children of a prior marriage, they may have grown past the age where parental support is legally required or will not have too much longer to go. If making the earnings of the subsequent spouse liable for such support after five years places a burden upon the subsequent marriage, perhaps this is where it belongs. If a parent cannot meet that parent's legal support obligation for his or her offspring, it is not in the best interest of society that said parent start up a new family which may require additional child support .

2.) Post-Nuptial Debts:

Present California law holds that "the property of the community is liable for the contracts of either spouse which are made after marriage...."[7] California employs the "managerial system":

> "Creditors under this system may satisfy their debts out of property over which the debtor spouse has management and control. In California, this means that generally a creditor may reach the separate property of the debtor spouse and all the community property since the spouses have equal management and control of the community property."[8]

There are two areas that are exceptions to this rule and the liability of

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[7] Civil Code Section 5116(c).

[8] California Law Revision Commission, TENTATIVE RECOMMENDATIONS, June 1980, page 2.

the community property for the debts of the non-controlling spouse is not clear in these areas: first, the spouse who is managing a community property business has the "sole management and control" of the business and secondly, a bank account in the name of one spouse is free from the control of the other spouse.[9]

Tentative recommendations which should be effectuated, have been made by the California Law Revision Commission to eliminate this uncertainty by specifically making community property where the one spouse has management and control liable for those debts. However, even when clarified, a burden of tracing is left on the creditor to determine, for example, the origin of monies that went into a bank account under the control of one spouse, and if said monies were indeed community property or the separate property of the owner spouse. Eliminating the tracing problem after a reasonable interval of marriage, (point 4 above) would not only bring down the costs of financing, but would assist spouses in establishing their credit lines and limits with much greater certitude.

3.) Tort Debts:

California community property law holds all of a debtor's separate property as well as the community property liable for the debts of the spouse incurring the debt. It avoids establishing an order of priority between application of the separate or the community property to the debt, except in the case of debts incurred for the purpose of satisfying a tort judgment. If the activity giving rise to the tort was an "activity for the benefit of the community, the liability shall first be satisfied from the community property and second from the separate property of the married person."[10] If said activity was not for the benefit of the community, liability is satisfied the other way around, first from the tortfeasor's separate property, and second from the community

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[9]Civil Code Section 5125(d), and Financial Code Section 851.

[10]Civil Code Section 5122(b)(1).

property.[11]

Extensive tracing by the creditor is necessary to determine whose property, separate or community, is involved, and if it is commingled sufficiently to be designated as community property. Further, distinctions are set up between the type of tort activity, those "for the benefit of the community" or otherwise. Under the proposed changes such procedures would continue to apply only to torts. During the first five years of marriage, pre-marital torts would be handled as they are now, except the community property would not include the earnings of the non-tortfeasor. After the first five years of marriage, all the community property would be liable, including earnings of the non-tortfeasor (point 2 above), on a priority basis. At no time would the separate property of the non-tortfeasor be liable.

3.) Inter-spousal Transfers:

California law is very liberal in permitting transmutation of community property to separate property or vice versa, by agreement of the spouses with or without notice to creditors. Even an oral agreement, "if fully executed," will be upheld.[12] "Fully executed", according to case law,[13] means that the acts of the parties must confirm the change in character of the property; and even this requirement is not indispensable.[14] This is a judicially created exception, in the case of real property, to the Statute of Frauds, and the rule has been criticized therefore.[15]

Thus, the husband may make a gift of community property to the wife and it thereby may become her separate property. Examples are

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[11] Civil Code Section 5122(b)(2).

[12] 7 Witkin, Summary of California Law, Community Property Section 73 (8th ed. 1974).

[13] Kinney v. Kinney (1934) 220 C. 134, 30 P. 2d 398.

[14] Woods v. Security First National Bank (1956) 46 Cal. 2nd 697,701, 299 P.2d 657.

[15] See 42 Cal. Law Rev. 371; 9 Stanford Law Rev. 183.

insurance policies taken out with the wife as beneficiary, the premium paid with community property funds; a deed executed to the wife as grantee at the husband's request;[16] withdrawal of money from a joint account and deposit in the wife's separate account, stating it belonged to her;[17] use by husband of community property funds to improve wife's separate property. Frequently such gifts and agreements are used as a device to circumvent creditors and avoid potential tort liability.

Some courts permit only spouses who are not in debt to make a gift to the other.[18] Others limit the right to a spouse who, at the time, has ample means to satisfy his creditors.

Other states provide that such transfer does not affect existing equities of creditors.[19] It is this latter proposition that should be established here. Clearly, the parties have every right to dispose of their property as they see fit, but they should not be allowed to confuse or defeat the reasonable expectations of their creditors thereby. Thus, even if earnings of one spouse are made the separate property of the other spouse by gift or agreement, as to the creditors, said earnings should be SCR property, subject to the rights of indemnification between the spouses according to their agreement. The Fraudulent Conveyance Act is too easily defeated; fraud is too difficult to prove, and the legal proceedings involved in challenging such transfers are too uncertain and costly. What is community property and what is separate property should be clearly and legally defined. Exceptions to these definitions by agreement of spouse should be binding between the spouses but not on creditors' rights.

4.) Liability AFTER Dissolution:

Of paramount interest to the creditor is the disposition of his debt at

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[16] Miller v. Brode (1921), 186 C. 409, 199 P. 531.

[17] Rice v. Ransom (1960) 186 C.A. 2d 191, 8 Cal. Rptr. 840.

[18] Rico v. Brandenstein, 98 Cal. 465, 33 P. 480.

[19] Sallaske v. Fletcher, 73 Wash. 593, 132 P. 648.

time of dissolution when the court makes division of the community property "equitably and equally" between the spouses. The community property and the marital debts are characterized by the court as separate or community property and are divided between the spouses. However, a creditor may still satisfy the debt out of any property that would have been liable for the debt before division.[20] This is true even if the debt is assigned to the debt-creating spouse and the bulk of the community property to the non-debt creating spouse. This provision is fair and should not be changed.

The debt may also be assigned to the non-debtor spouse and theoretically the debtor is no longer liable, although in some circumstances reimbursement rights remain between spouses. A proposal has been made to eliminate all liability of the spouse, even if he were the original debtor, after such assignment to the other spouse. Such a change is not equitable to creditors. Whereas the creditor had two debtors to collect from prior to dissolution of a marriage, he may be left with only one afterwards, conceivably the spouse who may have received little of the community property by court decision or by private settlement agreement. Decisions of property divisions made by spouses at the time of dissolution tend to be hasty and emotional. The present liability for debts after dissolution should be retained.

For non-tort debts incurred after seven years of marriage prior to dissolution, the creditor could look to all property of both spouses according to this proposal (point 4). The non-debtor spouse may have reimbursement rights against the debtor spouse according to agreement between spouses.

5.) Liability For Annulled Marriages and Similar-To-Marriage Living Arrangements:

In both instances, the marriage that ends in annulment and the living

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[20] Vest v. Superior Court, 140 Cal. App. 2d 91 294 P.2d 938 (1956).

arrangement that terminates after five years, the statute should provide that creditors' rights are the same as against property of a valid marriage that ended in dissolution. These parties held themselves out as being married, or as living in a de facto state of marriage, and third party creditors should be entitled to rely on such representations without detriment.

In the case of the living arrangement that endures over five years, there is no reason why the income of the partners should not be treated as community property. Such an arrangement has already outlasted a high percentage of conventional marriages. It may be compared to a partnership, which can also be formed by intent and by action without formalities of a written signed instrument. Although it is not the purpose or responsibility of the creditor to foster social mores, nevertheless the laws should not be blind to realities of changing life styles. To exempt the income of partners to living arrangements from the debts of their long-term cohabitants is to penalize those who do make conventional commitments and enter into valid marriage agreements. Further, in most cases both partners benefit from the income and living standards of the other, and should, therefore, share the risks and liabilities as well as the benefits of combined incomes.

6.) Rents, Issues, and Profits From Separate Property:

It is expressly provided by statute that the rents and income of the separate property of either spouse are the separate property of that spouse.[21] For example, interest on a bank account acquired by a spouse before marriage, profit on a sale of separate property and the increase in value of separate property. By implication, the converse is impliedly true -- rents and profits of community property are community property.[22]

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[21] Civil Code Section 5107 (wife) 5108 (husband).

[22] Re Estate of Brady, 171 C. 1, 151, P. 275, Re Estate of Battay, 13 C.2d 702, 91 P.2d 1042.

At this point there is a complication in the application of the law. If the increase in the value of the separate property is attributable to the ability or capacity of the spouse owning the separate property, it is ordinarily held to be community property; but if the increase is due to the natural enhancement of values generally, it continues as separate property.

> "If the owner of the separate property does not use it in any business or employment, but merely cares for and preserves it, the income is also separate property. If, however, one of the spouses invests his or her separate property in a business and conducts that business during marriage, the resulting profits are community and separate property in proportion to the amounts attributable to that spouse's personal efforts and to capital investment, respectively. An apportionment of profits is required not only when one of the spouses conducts a commercial enterprise but also when that spouse invests separate funds in real estate or securities."

> "What amount of the profits of a business conducted by one of the spouses is due to the personal efforts of that spouse and what amount is attributable to his or her capital investment must, in each case, be determined from the surrounding facts and circumstances. In making such apportionment between separate and community property, the courts have developed no precise criterion or fixed standard, but have endeavored to adopt that yardstick which is most appropriate and equitable in a particular situation, depending on whether the character of the capital investment in the separate property or the personal activity, ability, and capacity of the spouse is the chief contributing factor in the realization of income and profits."[23]

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[23] Commissioner v. Skaggs (CA5) 122, F.2d 721, Cert. den. 315 U.S. 811, 86 L.Ed. 1210, 62 S.Ct. 796.

The Courts have evolved two separate theories to make the allocation of earnings between separate and community income: the Van Camp method and the Pereira method.

Any lawyer involved in these complicated determinations knows that the distinction between whether an increase in value is due to "natural enhancement" or "ability and efforts" of the individual spouse is a specious one, for the reson that whatever one does in managing one's assets, even the decision to do nothing (for example, to hold real estate and not sell it), it is an exercise of one's judgment and acumen. Fortunes have been lost in the stock market on a rising market. Whatever position taken, to hold, sell, or reinvest, said decision is the reflection of the business talents of the owner spouse.

The concept of income from separate property as community property during marriage is not a new one. In some community property states, the fruits and profits of separate property accruing during marriage are community property, and community property states, among themselves, vary greatly. The issue is further complicated by differences in the legal treatment of non-residents who own immovable property in a community property state. In that case, the law of situs governs the character of the income derived therefrom. The distinctions arising from what is separate property, because of its source, and whether it should be classified as community property income because it is the product of individual toil of either spouse, becomes very blurred. For example, a cash dividend may be held to be community property as fruits and profits, whereas an ordinary stock dividend is separate property because "it is not an increase in the spouse's interest in the corporation's assets, but merely a change in form."[24]

From an equitable standpoint, the present California law places a penalty on the spouse who brings only the income from his labor to a marriage. His earnings are historically community property, subject to community debts, whereas the spouse who does not earn wages or a salary and who has a considerable portion of his income in the form of inherited assets, may enter and leave a marriage, with his separate wealth intact, despite having extensive community debts.

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[24] 15A Am. Jur. 2d 661, Community Property Section 38.

The proposal herein , (point 3) that income from separate property should be SCR property, would eliminate such inequities between married partners, and would simplify and lend certainty to a confused situation.

D. "SUBJECT TO CREDITORS RIGHTS PROPERTY"

The concept of SCR Property is suggested to separate the ancient argument of which spouse owns what property, from what properties involved in the marriage are subject to liability for the debts of the spouse. Simply put, it means that after some time period, e.g. three years, five years, seven years, the marriage will have stabilized so that the spousal interests have merged to the point where both spouses benefit from the obligations and investments of the other. At this point in time, both spouses should take responsibility for the debts of the other.

From the standpoint of creditors, after a seven year marriage, it no longer would make any difference how spousal property is characterized, separate or community, all property owned by both spouses would be liable for all debts of the spouses, with the exception of tort liabilities. No tracing would be required prior to executing on spousal property. Nor would it be required that a creditor determine if a spouse has sole management and control. By designating income from separate property as SCR property from the time of marriage, one retains the characterization of the income producing asset as separate property at time of dissolution or death according to the desires of the spouses, but, during marriage, as to creditors, it is liable for the debts of the spouses exactly as though it were community property, and subject to indemnification rights between the spouses by their agreements.

After two persons have been married for seven years, it may be assume they know well what to expect from each other by way of debt and liability, and it is not inequitable for them to share their responsibilities. Many changes have taken place in community property law in the recent past to equalize the status of both spouses. Now it is time that creditors' rights as well be given fair and equitable treatment. It is to everyone's advantage, in terms of less costly and more readily available credit, for both parties to a mature, enduring marriage to take full responsibility for all debts and liabilities of that marriage.

EXHIBIT 6

REPORT ON LAW REVISION COMMISSION'S RECOMMENDATIONS ON LIABILITY OF MARITAL PROPERTY

The following constitutes the report of the Business Law Section of the State Bar of California on the recommendations of the California Law Revision Commission on the Liability of Marital Property for Debts: Study D-312. The proposed statutory amendments are annexed hereto as Exhibit "A". The provisions of the recommendation are supported unless commented upon specifically.

A. §5120.005; Recommendation: Support If Amended

It is the recommendation of the Section that §5120.005 be redrafted. The opening phrase of sub-paragraph (a) provides that "unless the provision or context otherwise requires, as used in this chapter, 'debt' means any obligation incurred by a spouse whether based on contract, tort, or otherwise." The Section believes that there is an ambiguity created by this initial clause and that those contexts where the definitions do not apply should be identified. Furthermore, the phase "incurred by a spouse" should be clarified to indicate whether the reference is made to debts incurred by a married person subsequent to marriage, or incurred by a married person whether or not married at the time the debt was incurred.

With respect to sub-paragraph (b)(1), the Section is concerned with the definition of when a contract debt is "incurred". Under the existing provision, a contract debt is incurred "at the time the contract is made." It does not appear to the Seciton that this definition adequately covers certain circumstances which may arise. For example, in those contracts which call for performance over time, such as in the case of a long term lease or a supply or performance contract, it should not necessarily be the case that the rights of a creditor to reach community property should always be determined as of the date the contract was made. For example, if a long term lease is current throughout the term of the marriage and subsequently goes into default after separation or even after division of the community property assets, it does not seem equitable to allow the creditor to pursue its claim as against the other spouse's share of the community property.

The problem referred to in the preceding paragraph may raise a much broader problem which does not seem to be adequately addressed by the statute. Namely, what is the obligation of community property for debts incurred by a spouse after formal separation, but prior to a final divorce decree or property division? We know that assets acquired during this period are separate property, but what of the debts? It is the feeling of the Section that a spouse, after formal separation, ought not be put at risk for his or her one-half interest in the community property because of the business activities of the other spouse after separation. For example, if after separation a spouse engages in a business venture which proves to be disasterous, the other spouse's one-half interest in the community property should not be required to pay these post-separation debts.

Accordingly, it is the recommendation of the Section that the Law Revision Commission address the problem of debts incurred by a spouse subsequent to separation. It is the Section's recommendation that such creditors be allowed to reach only that portion of the community property which would have been awarded to the debtor-spouse had division of the community property taken place as of the date of formal separation.

B. §5120.010; Recommendation: Support.

Section 5120.010 continues existing law in the case of contract debts and clarifies the fact that a community property business under the sole management and control of one spouse is fully liable for the obligations of the non-business spouse. Under §5120.010, all community property is liable for a contact or tort debt of either spouse incurred before or after marriage. While the Section recognizes that this raises a very difficult problem in the case of a solely-managed community property business, and that as a matter of family law it is desirable to preserve the business unit to provide a source of income for the family, on balance the Section recommends that §5120.010 be supported.

Because of the difficulty of levying on other property of spouses, the community property business assets represent one of the last types of easily accessible assets from which to satisfy a judgment. To the extent that satisfaction of the non-business spouse's debts from the business assets could usurp the business spouse's right to management and control, the Section feels that there are other means available by which the business can be insulated from the individual debts of the other spouse. For example, the spouses could agree formally to conduct their business

as a partnership or limited partnership. By such agreement, the spouses would insulate the business from their individual creditors and grant a priority in payment to the business creditors of the partnership.

Any scheme that would attempt to exempt a business operated as a sole proprietorship from the claims of the creditors of the non-business spouse would also create an unfair advantage vis a vis the individual creditors of the business spouse who would not be foreclosed from reaching the business assets.

The Section recognizes that as a result of § 5120.010 the non-business spouse has the ability to file a bankruptcy case, thereby transferring the business spouse's solely managed community property business to the non-business spouse's bankruptcy estate. Nevertheless, the ability of the business spouse to intervene in the bankruptcy case and/or file his or her own Chapter 11 case, thereby possibly regaining management and control over the business as debtor in possession, obviates the leverage which might otherwise be obtained by a vindictive spouse.

Present section 5122 is also repealed and proposed 5120.010 will treat tort debts just like contract claims. It is the Section's belief that present §5122 is superfluous and unnecessarily complicates the enforcement of judgments. There are numerous situations which could arise where a tort is not easily identifiable as a "separate" tort or a "community" tort. For example, consider an injury to a invitee on property which is a percentage community property with the remainder separate property. This situation is wholly unworkable under present §5122 and burdensome for creditors.

Section 5122 has been enacted since 1975, and there have been no reported cases thereunder. It is the Section's belief that the Law Revision Commission's recommended repeal of §5122 should be supported with a provision creating a right of reimbursement (within a limited time period) as between the spouses in both contract and tort cases.

Subsection (b) continues existing law and contains an important clarification of the right to trace wages of the non-debtor spouse.

C. §5120.030; Recommendation: Support if Amended.

The Section expresses the same reservations regarding debts incurred after separation but prior to dissolution, as were expressed under §5120.005. The Section believes, however, that §5120.030(b) which requires the naming of a spouse in order to hold that spouse's separate property liable for a debt arising from the necessities of life is an important clarification of law. The Law Revision Commission may wish to consider whether or not to provide a similar provision to the effect that it is not necessary to join a spouse to satisfy a claim out of community property, and more fully explain the manner in which to join a spouse in those circumstances required by §5120.050.

The grave difficulty with proposed §5120.030 is its interrelationship with Bankruptcy Code §544(a), which section gives the Trustee as of the commencement of the case the rights and powers of a creditor of the debtor. If the Trustee may asset this right in the form of a "necessaries" creditor under section 5120.030, he may be able to bring all the non-debtor's separate property into the bankruptcy estate to be shared by all creditors.

A better approach to section 5120.030 would be to have the non-debtor spouse be directly liable on the "necessaries" obligations, and not merely make his or her separate property liable. Note that the affect with respect to the property available to a necessaries creditor is the same in both cases, but the direct liability is preferable in four important ways:

1. The Trustee could not reach the property under §544(a) because the property would not be liable for a debt of the bankrupt; it would be liable because of the other spouse's personal liability.

2. The property would not be brought into the bankruptcy estate and shared with all creditors; rather, the necessaries creditor would be favored in being able to directly persue the other spouse's assets alone.

3. The discharge of a spouse would not affect the liability of the other spouse to the necessaries creditor, thereby enhancing such a creditor's possibility of payment.

4. The community property laws would be more consistent for all creditors of all types.

The Section recommends direct liability of both spouses for necessaries claims, if it is the desire to allow "necessaries" creditors to reach the separate property of the non-debtor spouse.

D. §5120.040; Recommendation: Oppose.

This provision explicitly provides that the Uniforn Fraudulent Conveyance Act applies to transfers between the spouses. The Section is adamantly opposed to this provision. This provision is wholly unnecessary as it merely codifies existing law, and there has never been any question that the Uniform Fraudulent Conveyance Act applies to such transfers. The difficulty with this statute is that by its enactment, it creates an ambiguity because there are other fraudulent conveyance provisions such as Civil Code §3440 and the bulk transfer laws which also apply to spousal transfers. It is the fear of the Section that by omission of these provisions in any codification, there will be a negative implication that these sections do not apply. The Section is satified that present law is clear.

E. Section 5120.050: Oppose.

Section 5120.050 does contains one important clarification of the law. Under subsection (a)(1) property received by a spouse remains liable after dissolution for the debts of that spouse. The Section does not object to this section.

Subsection (a)(2) is the key provision. It allows a creditor of one spouse to seek satisfaction of his or her claim from former community property in the hands of the other spouse after dissolution. This may be necessary because the creditors are not paid in the dissolution proceeding and are not assured payment by the award of liabilities to a particular spouse. Presently, it is necessary to show that a fraudulent conveyance was involved (if a court decree could be so characterized) to reach such property. Compare Vest v. Superior Court, 140 Cal. App. 2d 91, 95 (1956) with Britt v. Danson, 334 F.2d 896 (9th Cir. 1964). If the judgment is taken after division of the community property, under proposed section (a)(2) the other spouse must be named as a judgment debtor.

First, if § 5120.050(a)(2) is to be retained, the procedure for naming the other spouse as a judgment debtor should be clarified. After all, the non-debtor spouse "judgment debtor" is not liable on the debt.

The Section believes, however, that the provision should be re-written to greatly narrow its scope. The first difficulty arises with the fact that section 5120.050 contains no time limits. Thus, referring back to the prior definition of when a debt is "incurred," a debtor with a secured equipment loan could be current at the time of dissolution, and go into default years later, thereby giving rise to a claim against the non-debtor spouse's awarded community property.

Alternatively, the property awarded each spouse could be more than sufficient to pay all of the debts imposed upon that spouse at the time of dissolution. Yet, through bad business ventures, squandering of assets, or even gifts, the assets of one spouse could disappear through no fault of the other spouse. Under the proposed section, the awarded community property to the innocent spouse could be at risk years later. Such remote liability from a marriage dissolved years earlier is not desirable from a policy standpoint.

The Section recommends a modified fraudulent conveyance provision. Thus, the Commission should consider limiting (a)(2) to instances where, after eliminating exempt assets, the assets divided are insufficient to pay the debts assigned to a particular spouse. In such cases, creditors should be given three years to bring suit against the other spouse's community property award. (Identical to Fraudulent Conveyance Law). However, under circumstances where the spouses are each solvent after division (on the modified solvency test which excludes exempt assets), the division would be final and the spouses would be free to pursue their own lives without interference from the other spouse's pre-separation creditors at some later date. Creditors are adequately protected by this proposal, for even in marriage the spouses could have given away their property if they remained solvent after the gift. The Section believes its proposal is a highly desirable clarification and an improvement in existing law which limits the attack to standard fraudulent conveyance doctrine.

Repeal of Section 5123: The panel questions whether or not section 5123 should be repealed. Both spouses are required to sign a deed of trust to encumber real property. See §5127. Some provision should provide that executing such a deed of trust by a spouse does not render that spouse personally liable unless he or she also signs the note.

EXHIBIT 7

LAW OFFICES OF

JAMES R. TWEEDY, INC.

A PROFESSIONAL CORPORATION

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HAROLD L. GREENE
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September 19, 1980

Sandra Musser,
819 Eddy Street,
San Francisco,
CA 94109

Dear Sandy:

Pursuant to our assignment at the Committee meeting of September 13, 1980, Mike Leight and I have conferred on the two bills which were discussed at the meeting. We concur with the unanimous feeling of the Committee that both bills should be opposed in their entirety. The following is a summary of our discussion.

LAW REVISION COMMISSION RECOMMENDATIONS OF JUNE 13, 1980 RE LIABILITY OF OTHER SPOUSE FOR NECESSITIES OF LIFE. The proposal would seek enactment of legislation which would make a spouse liable for debts incurred after separation by the other spouse for necessities of life. Existing law cuts off such liability after separation "by agreement" so that depending on how strictly the requirement of an agreement is construed, the proposal may not change much in effect. Perhaps our recommendation should be expanded to include the elimination of the requirement of an agreement from Civil Code Section 5131. In any event, we strongly concur with the Committee in opposing the Commission's recommendation.

A separated spouse in need of support should be encouraged to bring an O.S.C. and apply to the Court for relief. Giving her (perhaps I should include here the usual disclaimer regarding use of gender) the power to unilaterally incur debts for which her spouse may be liable may even deny due process to the supporting spouse. We felt is was not equitable that the supported spouse should be able to make her own determination of what she needs and she should be required to make a showing to a court as to her needs and the ability of the supporting spouse to pay.

The Commission's recommendation would encourage the supported spouse to incur debts with no apparent limitation imposed and no safeguards against using the device as an outlet for hostility. Furthermore, the supported spouse could under the proposal obtain a temporary order for support, use that money for frivolities and then incur additional debts for necessities, circumventing the authority of the court, the intent of the order and the reasonable expectations of the parties and their counsel.

We also felt that there would be fewer stipulations at O.S.C. hearings since the outcome would be less predictable. Counsel for the supporting spouse would not be able to give a complete and reasonably accurate estimate of the support exposure to his or her client if the supported spouse has the power to incur debts without notice.

The law of debtor/creditor relations should be influenced if not governed by the reasonable expectations of both parties. The typical creditor will expect to be paid by the person to whom goods are sold or services provided. Most would not extend credit relying on payment by a person with whom they have had no contact. The proposal would remove further the state of the law from the reasonable expectations of potential creditors.

Administrative problems would be complicated by the proposal. Many new issues are injected into a case if one person can incur debts for whom another will be liable. The simple approach of requiring a creditor to seek recourse against the persons with whom he has dealt minimizes administrative problems.

We further disliked the proposal because it moves away from individual responsibility for one's acts and debts.

Finally, the proposal does not address the problem of how such debts are to be treated in the property division - whether they are community or separate debts regardless of who is liable to the creditor. While the report purports to take on the whole field of marital debts, it would aggravate problems in certain areas without dealing with some of the serious and common problems that exist at the present time. There is precious little law dealing directly with a definition of a community debt and how it is to be handled in the property division. The open account or continuing guarantee problem most

common in the area of credit cards is a serious one and also needs to be dealt with.

PROPOSED AMENDMENT TO CIVIL CODE SECTION 4800. The proposal would add a Section 4800 (d) (4) requiring the Court to take into consideration a number of items in dividing debt.

The proposed language includes the rights of creditors as one of the factors to be taken into consideration. The language is ambiguous as to what policy is being promoted and why the legislation is needed at all. The language is also ambiguous in that it does not say whether it is dealing with the cash flow aspects of debt payment or whether debts are to be assigned without credit against support obligations or property division. Nor does it discuss how such an assignment of debts would affect the credit for debts paid from separate earnings after separation.

If the Section empowers the Court to assign debts of a solvent community without credit against support or property division, it penalizes a working spouse because he or she will be the one who is assigned the debts.

We concur with the Committee that the legislation should be opposed since, in summary, it injects much ambiguity into the Section and is not needed under present law to allow the Courts to give equity.

Best regards.

Sincerely,

JAN C. GABRIELSON

JCG:pf

EXHIBIT 8

Bruch and Riesenfeld: Proposed Draft of Section Implementing Orders of Satisfaction

§ _____. RELATIVE RIGHTS OF SPOUSES. Where a creditor's resort to a debtor's separate or community property is subject to an order of satisfaction, either spouse may require that the creditor's payment be made according to that order so far as it can be done without impairing the right of the creditor to complete satisfaction, and without doing injustice to third persons. Either spouse may assert his or her right by way of

(a) an action to enjoin the other spouse from making any payment inconsistent with that order;

(b) an action for reimbursement from the other spouse for any payment made inconsistent with that order;

(c) an action to direct the other spouse to make payment according to that order;

(d) a claim pursuant to Division 4 (commencing with Section 720.010) of the Code of Civil Procedure. For the purposes of those sections the right of a spouse under the order of satisfaction is a right superior to the creditor's lien. Notwithstanding any other provision of law,

(1) the filing of a claim pursuant to this subdivision stays a sale of the property under a writ, or a transfer or other disposition of the property levied upon, subject to the court's power to impose conditions or vacate the stay upon such terms as are just;

(2) the property shall remain subject to the creditor's lien until the creditor's claim is satisfied; and

(3) the court may order that property alleged by the claimant

to be liable to prior resort be turned over to the sher iff; the court's order shall have the effect of a levy for the purposes of permitting the assertion of defenses, exemptions, and third party claims.

COMMENT

An order of satisfaction is imposed, for example, by Civil Code § 5122(b), which regulates the relative liability of community and separate property for a spouse's tort. In order to invoke this section's provisions, the spouse must establish both the relevant order of satisfaction and that property of prior resort is available for payment of the claim or was available at the time that payment from a source of lesser priority was made.

STATE OF CALIFORNIA

C A L I F O R N I A L A W
R E V I S I O N C O M M I S S I O N

TENTATIVE RECOMMENDATION

relating to

LIABILITY OF MARITAL PROPERTY FOR DEBTS

June 1980

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

TENTATIVE RECOMMENDATION

relating to

LIABILITY OF MARITAL PROPERTY FOR DEBTS

General Approach

The eight community property jurisdictions in the United States have developed three distinct systems of applying marital property to the debts of one or both spouses.[1] Each system protects the marital property from creditors to varying degrees by creating exceptions to liability of the property for debts.[2]

The system least favorable to creditors is that developed in Washington and Arizona, which requires a classification of debts as community or separate.[3] All community property and the debtor's separate property is liable for a "community" debt, but only separate property of the debtor spouse is liable for a "separate" debt. Since in the ordinary case a substantial portion of the marital property is community, a creditor holding a separate debt may find the debt uncollectable. A practical consequence of this system is that creditors require consent of both spouses before extending credit and courts strive to classify debts as community in order to avoid unfairness to creditors.

A system more favorable to the interests of creditors is that developed in New Mexico. Under this system, debts are classified as community or separate, community property being liable for community debts and separate property of the debtor spouse being liable for that

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1. Reppy, Debt Collection From Married Persons in California, at p. 3 (1980). This is a study prepared for the California Law Revision Commission, which is hereinafter cited as "Study." Copies of the study are available from the Commission on request. The study is scheduled for publication in the San Diego Law Review in revised form in October 1980.

2. Marital property consists of the community property and the separate property of either of the spouses, but the separate property of the nondebtor spouse is ordinarily immune. In California, the separate property of a nondebtor spouse is liable for support obligations of the debtor spouse in limited situations. Civil Code §§ 5131-5132.

3. For a discussion of the debt classification system, see Study at pp. 3-5.

spouse's separate debts. In the case of a separate debt, if the separate property is exhausted and the debt remains unsatisfied, the creditor may reach the debtor's half-interest in the community property, in effect forcing a partition. The mechanical operation of such a scheme, and the subsequent readjustment of property rights between the spouse, is not clear.[4]

Most community property states, including California, employ a system that is most favorable to creditors. Creditors under this system may satisfy their debts out of property over which the debtor spouse has management and control. In California, this means that generally a creditor may reach the separate property of the debtor spouse and all the community property since the spouses have equal management and control of the community property.[5] This general rule is subject to exceptions, which are dealt with below.

Of the possible approaches to liability of marital property for debts, the managerial system (which is the present California system) is generally most sound in theory and practice. It gives greatest assurance that debts of the spouses will be satisfied, subject to the statutory scheme of exemptions which will preserve property necessary for basic needs of the spouses.[6] Systems that require characterization of type of debt and partition of community property create serious administrative problems. Moreover, liability of the property over which the debtor has management and control conforms to the reasonable expectations of both spouses and creditors. The Commission recommends that the general approach of existing California law to liability of marital property for debts be preserved.

Property Under Management and Control of One Spouse

Under California's managerial approach to liability of marital property, property over which a spouse has management and control is

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4. For a discussion of the partition system, see Study at pp. 18-19.

5. For a discussion of the California managerial system, see Study at pp. 23-27.

6. See discussion below under "Exemptions."

liable for the debts of the spouse.[7] Since both spouses have equal management and control of the community property, this yields the rule that all community property is liable for a debt of either spouse.

California law, however, prescribes two situations where community property is under the management and control of only one spouse. A spouse who is operating or managing a business that is community personal property has the sole management and control of the business.[8] A community property bank account in the name of a spouse is free from the control of the other spouse.[9] Whether these two types of community property are liable for a debt of the spouse not managing and controlling the property is not clear.[10]

The policy supporting liability of community property for a debt of either spouse incurred before or during marriage--maximum protection of creditors' rights with minimum procedural burdens--also supports liability of the property regardless whether it is under the management and control of one or both spouses. The law should make clear that the community property is liable for a debt of either spouse notwithstanding the concept that liability follows management and control.

Priority of Application of Property

Under the California approach to liability of marital property, all of the community property as well as the debtor's separate property is liable for a debt of the spouse. If the debt was incurred for community purposes, an argument can be made that the community property should be first exhausted before resort to the debtor's separate property is permitted. If the debt was incurred for separate purposes, an argument

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7. See Study at pp. 23-27; see also 1974 Cal. Stats. ch. 1206, § 1, p. 2609:

> The Legislature finds and declares that . . . the liability of community property for the debts of the spouses has been coextensive with the right to manage and control community property and should remain so . . . .

8. Civil Code § 5125(d).

9. Fin. Code § 851.

10. See Study at pp. 48-56.

can be made that the separate property of the debtor should be first exhausted before resort to the community property is permitted.

Existing California law prescribes an order of priority in two situations. Civil Code Section 5122(b) requires a determination whether or not a tort judgment arises out of an activity that benefits the community--if so, the judgment must be satisfied first out of community property and then out of the separate property of the tortfeasor; if not, the judgment must be satisfied first out of the separate property of the tortfeasor and then out of community property.[11] Civil Code Section 5132 requires a spouse to support the other spouse out of separate property if there is no community or quasi-community property.[12]

A priority scheme creates a number of practical problems. It requires a procedural mechanism for determining whether the debt is community or separate in character. It requires a creditor who seeks to satisfy the debt out of one type of property to ascertain whether the other types of property have been exhausted; this may involve cumbersome court proceedings. Moreover, even if there are other types of property that have not been exhausted, a priority scheme may require the creditor

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11. Civil Code Section 5122(b) provides:

> (b) The liability of a married person for death or injury to person or property shall be satisfied as follows:
>
> (1) If the liability of the married person is based upon an act or omission which occurred while the married person was performing an activity for the benefit of the community, the liability shall first be satisfied from the community property and second from the separate property of the married person.
>
> (2) If the liability of the married person is not based upon an act or omission which occurred while the married person was performing an activity for the benefit of the community, the liability shall first be satisfied from the separate property of the married person and second from the community property.

12. Civil Code Section 5132 provides:

> 5132. A spouse must support the other spouse while they are living together out of the separate property of the spouse when there is no community property or quasi-community property.
>
> For the purposes of this section, the terms "quasi-community property" and "separate property" have the meanings given those terms by Sections 4803 and 4804.

to seek satisfaction from property that is likely to be exempt or that is of such a nature that the cost of applying it to the judgment will exceed its worth.

The California statutes do not attempt to resolve these problems and there is no useful experience of operation under them.[13] Other jurisdictions have enacted limited priority schemes, but these schemes offer no useful guidance; apparently, elaborate court proceedings are required to make them operable.[14]

The Commission believes the mechanical problems caused by an order of priority of application of property are too great to justify such a scheme. A creditor should be able to reach any property that is liable for the satisfaction of the judgment without the burden of first seeking out and attempting to exhaust particular classes of assets. The existing California priority provisions should be repealed. [In place of the priority provisions, the Commission recommends adoption of a reimbursement right between spouses, which is discussed below.]

Reimbursement

[Before legislation on this subject is recommended for enactment, the Commission plans to consider whether a reimbursement right between spouses should be adopted.]

Prenuptial Debts

If a person contracts a debt before marriage, the earnings of the person's spouse after marriage are not liable for the debt.[15] This rule implies two corollaries:

(1) Community property other than the earnings of the nondebtor spouse after marriage is liable for prenuptial contract debts.

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13. See generally discussion in Note, Tort Debts Versus Contract Debts: Liability of the Community Under California's New Community Property Law, 26 Hastings L.J. 1575 (1975).

14. See Bingaman, The Community Property Act of 1973: A Commentary and Quasi-Legislative History, 5 N.M. L. Rev. 1 (1974).

15. Civil Code § 5120.

(2) The earnings of the nondebtor spouse after marriage are liable for prenuptial tort debts.

The first corollary is correct. Since the debtor spouse has a half-interest in community property, all community property other than earnings of the nondebtor spouse (which is peculiarly personal) should be liable for the satisfaction of the prenuptial debt. This principle should be codified expressly.

The second corollary is not correct. There is no sound basis to distinguish prenuptial tort and contract debts. The earnings of the nondebtor spouse should not be liable for any prenuptial debts of the debtor spouse, whether based on contract or tort.

A related matter is how long the earnings of the nondebtor spouse should remain not liable for a prenuptial debt of the debtor spouse.[16] The Commission recommends that the earnings should lose their protection from liability upon a change in form, but that they should retain their protection so long as traceable in bank accounts. This will ensure that substantial amounts of community property are not immunized from creditors, that the judicial system is not burdened by extensive tracing requirements, and that earnings will remain exempt so long as they retain their peculiarly personal character. This will also parallel the protection the Commission tentatively plans to give funds exempt from enforcement of judgments.[17]

Liability for Necessaries

Under existing law, separate property of a spouse is not liable for the debts of the other spouse except that the separate property is liable for the necessaries of life contracted by either spouse while living together.[18] This exception is based on the obligation of the spouses to support one another.[19]

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16. See Study at pp. 57-60.

17. See Recommendation Relating to Enforcement of Judgments, 15 Cal. L. Revision Comm'n Reports ___, ___-___ (1980).

18. Civil Code § 5121.

19. Civil Code § 5132.

The requirement that the necessaries be "contracted" is unduly restrictive. This language has the effect of immunizing the separate property from debts for necessaries such as emergency medical care not contracted by one of the spouses.[20] In such situations the separate property of the nondebtor spouse should be liable for the necessaries debt regardless of the contractual nature of the debt.

The separate property of the nondebtor spouse is liable for necessaries debts incurred only while the spouses are living together. After separation by agreement there is no liability unless support is stipulated in the agreement.[21] The provision abrogating the support obligation of the spouses in a separation by agreement penalizes spouses who need support following an informal separation and violates the policy of the Family Law Act requiring mutual support during marriage.[22] The presumption should be reversed--the separate property of the spouses should remain liable for the necessaries obligations incurred following separation unless liability is expressly waived in the separation agreement. However, after informal separation the property should be liable only for debts for "common" necessaries of life;[23] the nondebtor spouse should not be required to maintain the estranged spouse after informal separation in the accustomed style of life.[24]

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20. See, e.g., Credit Bureau of San Diego v. Johnson, 61 Cal. App.2d Supp. 834, 142 P.2d 963 (1943). Cf. St. Vincent's Institution for Insane v. Davis, 129 Cal. 20, 61 P. 477 (1900) (earlier statute).

21. Civil Code § 5131.

22. Bruch, The Legal Import of Informed Marital Separations: A Survey of California Law and a Call for Change, 65 Calif. L. Rev., 1015, 1030-31 (1977); Study at pp. 46-47.

23. Cf. Code Civ. Proc. § 723.051 (common necessaries exception to wage exemption); Ratzlaff v. Portillo, 14 Cal. App.3d 1013, 92 Cal. Rptr. 722 (1971) ("common" necessary is necessary required to sustain life).

24. Cf. Wisnom v. McCarthy, 48 Cal. App. 697, 192 P. 337 (1920) (under necessaries standard, maid necessary because of economic and social position of spouses).

Case law provides that the separate property of the nondebtor spouse may not be applied to the satisfaction of a judgment unless the nondebtor spouse is made a party to the action.[25] This rule is sound and should be codified. The nondebtor spouse, for due process reasons, should have the opportunity to contest the validity of the debt before his or her separate property is applied to its satisfaction.

Interspousal Transfers

A system prescribing the liability of separate and community property for the debts of spouses is subject to the ability of the spouses to transfer property between themselves thus affecting the character and liability of the property. California law is liberal in permitting transmutation of the character of property by spouses and requires few formalities.[26]

The general rule appears to be that if a transfer is not fraudulent as to creditors of the transferor, the transfer can affect the right of creditors to reach the property.[27] Whether a transfer is fraudulent as to creditors is governed by the Uniform Fraudulent Conveyance Act.[28] The rules prescribed in the Uniform Act are sound as applied to interspousal transfers, and the statute should make clear that the Uniform Act governs such transfers.[29]

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25. See, e.g., Evans v. Noonan, 20 Cal. App. 288, 128 P. 794 (1912); Santa Monica Bay Dist. v. Terranova, 15 Cal. App.3d 854, 93 Cal. Rptr. 538 (1971).

26. See, e.g., 7 B. Witkin, Summary of California Law Community Property § 73 (8th ed. 1974).

27. Cf. Bailey v. Leeper, 142 Cal. App.2d 460, 298 P.2d 684 (1956) (transfer of property from husband to wife); Frankel v. Boyd, 106 Cal. 608, 614, 39 P. 939, 941 (1895) (dictum); Wikes v. Smith, 465 F.2d 1142 (1972) (bankruptcy).

28. Civil Code §§ 3439-3440.

29. The Commission is currently studying the general rules governing transmutation of community and separate property between the spouses.

Anti-Deficiency Protection of Separate Property

Civil Code Section 5123 provides that in the case of a security interest in community property, the separate property of a spouse is not liable for any deficiency in the security unless the spouse gives express written consent to liability.[30] This provision is peculiar in protecting separate property of a spouse in the event of a deficiency but not other community property. It is thus inconsistent with general rules governing deficiency judgments.[31] Section 5123 was enacted for historical reasons that are now obsolete,[32] and should be repealed.

Liability After Division of Property

Upon separation or divorce, the community and quasi-community property and the debts are divided between the spouses.[33] Notwithstanding the division of property and debts, a creditor may seek to satisfy the debt out of any property that would have been liable for the debt before the division.[34] Thus, a creditor may reach former community property awarded to a nondebtor spouse even though the property division requires that the debtor spouse pay the debt. In such a situation the nondebtor spouse has a cause of action against the debtor spouse for reimbursement.[35]

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30. Civil Code Section 5123 provides:

> 5123. (a) The separate property of the wife is not liable for any debt or obligation secured by a mortgage, deed of trust or other hypothecation of the community property which is executed prior to January 1, 1975, unless the wife expressly assents in writing to the liability of her separate property for such debt or obligation.
>
> (b) The separate property of a spouse is not liable for any debt or obligation secured by a mortgage, deed of trust, or other hypothecation of the community property which is executed on or after January 1, 1975, unless the spouse expressly assents in writing to the liability of the separate property for the debt or obligation.

31. See, e.g., Code Civ. Proc. §§ 580a, 580b.

32. See Study at pp. 60-62.

33. Civil Code § 4800.

34. See, e.g., Mayberry v. Whittier, 144 Cal. 322, 78 P. 16 (1904); Bank of American v. Mantz, 4 Cal.2d 322, 49 P.2d 279 (1935); Vest v. Superior Court, 140 Cal. App.2d 91, 294 P.2d 988 (1956).

35. Study at pp. 70-71.

This scheme is unsound. It creates procedural burdens of tracing former community property in the hands of the nondebtor spouse and raises the problem whether the property should be traceable through changes in form after it has lost its community identity. These practical difficulties also demonstrate that the principles supporting liability of community property during marriage are not applicable after division of the property upon dissolution. Community property is liable during marriage because this avoids the serious administrative problems of characterizing the type of property and debt and partitioning the community property, and gives greatest assurance that creditors will be satisfied.[36] Upon dissolution, however, the property and debts are characterized as separate or community, and the community property and debts are partitioned among the parties; one or both of the spouses are required to satisfy the creditors. The administrative and policy reasons for undifferentiated liability of community property are thus eliminated upon dissolution and division of the property and debts.

Liability of community property for debts should cease upon dissolution and division of the property.[37] A creditor should be able to collect a debt from the person to whom the debt is assigned for payment, without regard to the type of property--former community or separate property--from which the debt is satisfied. This eliminates tracing problems and is consistent with the purposes of the Family Law Act to require payment of a debt by the person to whom the debt is assigned,[38] but does not impair the creditor's rights against the debtor.[39] In

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36. See discussion under "General Approach," supra.

37. Division of the community property does not affect enforceability of a valid lien on the property. See, e.g., Kinney v. Valentyne, 15 Cal.3d 475, 541 P.2d 537, 124 Cal. Rptr. 897 (1975).

38. The Family Law Act demands division of property and obligations so that the parties are placed in a position of equality. See Civil Code § 4800; In re Marriage of Schultz, 105 Cal. App.3d 846, ___ Cal. Rptr. ___ (1980).

39. Permitting a creditor to satisfy a debt out of property of a nondebtor spouse to whom the debt is assigned does not preclude the creditor from seeking to satisfy the debt out of the property of the debtor spouse as well. If the creditor satisfies the debt out of property of the debtor spouse, the debtor spouse has a right of reimbursement against the nondebtor spouse to whom the debt is assigned.

allocating the debts to the parties, the court in the dissolution proceeding should take into account the rights of creditors so there will be available sufficient property to satisfy the debt by the person to whom the debt is assigned.[40] If a judgment on the debt is entered after division of the property and debts, the judgment should not be enforceable against the nondebtor spouse unless the nondebtor spouse is made a party. This preserves the due process rights of the nondebtor spouse after division by providing the nondebtor spouse the opportunity to contest the validity of the debt, raise defenses, and take other necessary actions.

Liability After Judgment of Nullity

The law relating to creditors' rights against property of former spouses whose marriage has been annulled as void or voidable is not clear.[41] The statute should make clear that creditors' rights against property of an annulled marriage are the same as against property of a valid marriage that ended in dissolution. The parties held themselves out as being married and third persons relied to their detriment. Fundamental community property principles demand that there be a community of property formed between the parties for purposes of creditors' rights even though the marriage is ultimately held invalid.

Exemptions

A complex aspect of the liability of marital property for debts is the extent to which exemptions from enforcement of a judgment are recognized for community property and separate property of the nondebtor spouse. This matter will be dealt with separately in the Law Revision Commission's recommendation relating to enforcement of judgments.[42]

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40. Existing law requires an equal division of property and debts except in the case where liabilities exceed assets, in which case the court may adjust the division to reflect equitable considerations. See, e.g., In re Marriage of Fonstein, 17 Cal.3d 738, 552 P.2d 1169, 131 Cal. Rptr. 873 (1976) (equal division); In re Marriage of Eastis, 47 Cal. App.3d 459, 120 Cal. Rptr. 86 (1975) (unequal division). The court should have greater discretion to allocate debts taking into account the rights of creditors. Contrast In re Marriage of Schultz, 105 Cal. App.3d 846, ___ Cal. Rptr. ___ (1980) (no discretion).

41. See Study at pp. 77-85.

42. 15 Cal. L. Revision Comm'n Reports ___, ___-___ (1980).

The Commission's recommendations would be effectuated by enactment of the following measure:

An act to amend Sections 4800, 5131, and 5132 of, to add Section 5101 to, to add headings to Chapter 1 (commencing with Section 5100), Chapter 2 (commencing with Section 5103), Article 1 (commencing with Section 5103) and Article 2 (commencing with Section 5107) of Chapter 2, Chapter 4 (commencing with Section 5125), Chapter 5 (commencing with Section 5131), Chapter 6 (commencing with Section 5133), and Chapter 7 (commencing with Section 5138) of, and to add Chapter 3 (commencing with Section 5120.005) to, Title 8 of Part 5 of Division 4 of, and to repeal Sections 5116, 5120, 5121, 5122, and 5123 of, the Civil Code, relating to husband and wife.

The people of the State of California do enact as follows:

992/927

Civil Code § 4800 (amended)

SECTION 1. Section 4800 of the Civil Code is amended to read:

4800. (a) Except upon the written agreement of the parties, or on oral stipulation of the parties in open court, the court shall, either in its interlocutory judgment of dissolution of the marriage, in its judgment decreeing the legal separation of the parties, or at a later time if it expressly reserves jurisdiction to make such a property division, divide the community property and the quasi-community property of the parties, including any such property from which a homestead has been selected, equally. For purposes of making such division, the court shall value the assets and liabilities as near as practicable to the time of trial, except that, upon 30 days' notice by the moving party to the other party, the court for good cause shown may value all or any portion of the assets and liabilities at a date after separation and prior to trial to accomplish an equal division of the community property and the quasi-community property of the parties in an equitable manner.

(b) Notwithstanding subdivision (a), the court may divide the community property and quasi-community property of the parties as follows:

(1) Where economic circumstances warrant, the court may award any asset to one party on such conditions as it deems proper to effect a substantially equal division of the property.

(2) As an additional award or offset against existing property, the court may award, from a party's share, any sum it determines to have been deliberately misappropriated by such party to the exclusion of the community property or quasi-community property interest of the other party.

(3) If the net value of the community property and quasi-community property is less than five thousand dollars ($5,000) and one party cannot be located through the exercise of reasonable diligence, the court may award all such property to the other party on such conditions as it deems proper in its final judgment decreeing the dissolution of the marriage or in its judgment decreeing the legal separation of the parties.

(4) Educational loans shall be assigned to the spouse receiving the education in the absence of extraordinary circumstances rendering such an assignment unjust.

(5) In dividing the debts the court shall take into consideration the earning capacities of the parties and other relevant factors including the rights of creditors and shall make such a division as is just and equitable.

(c) Notwithstanding the provisions of subdivision (a), community property personal injury damages shall be assigned to the party who suffered the injuries unless the court, after taking into account the economic condition and needs of each party, the time that has elapsed since the recovery of the damages or the accrual of the cause of action, and all other facts of the case, determines that the interests of justice require another disposition. In such case, the community property personal injury damages shall be assigned to the respective parties in such proportions as the court determines to be just, except that at least one-half of such damages shall be assigned to the party who suffered the injuries. As used in this subdivision, "community property personal injury damages" means all money or other property received or

to be received by a person in satisfaction of a judgment for damages for his or her personal injuries or pursuant to an agreement for the settlement or compromise of a claim for such damages, if the cause of action for such damages arose during the marriage but is not separate property as defined in Section 5126, unless such money or other property has been commingled with other community property.

(d) The court may make such orders as it deems necessary to carry out the purposes of this section.

Comment. Paragraph (5) is added to subdivision (b) of Section 4800 to make clear the court's discretion to allocate debts in such a manner as to protect the rights of creditors by taking into account such factors as the earning capacity of the person to whom a debt is assigned, the exempt character of the property received by the person to whom the debt is assigned, and the separate property owned by the person to whom the debt is assigned. This abrogates the rule of In re Marriage of Schultz, 105 Cal. App.3d 846, ___ Cal. Rptr. ___ (1980) (no court discretion to adjust division of residual assets to reflect equitable considerations). The division of debts must be fair and equitable nonetheless, and the distribution of assets and obligations should be made in such a manner that the residual assets awarded to each party after deduction of the obligations are equal to the extent practical. See, e.g., In re Marriage of Fonstein, 17 Cal.3d 738, 552 P.2d 1169, 131 Cal. Rptr. 873 (1976) (equal division required); In re Marriage of Eastis, 47 Cal. App.3d 459, 120 Cal. Rptr. 86 (1975) (unequal division in "bankrupt family" situation).

406/456

Civil Code §§ 5100-5102 (chapter heading)

SEC. 2. A chapter heading is added immediately preceding Section 5100 of the Civil Code, to read:

CHAPTER 1. GENERAL PROVISIONS

15348

Civil Code § 5101 (added). Liability of married person for injury or damage caused by other spouse

SEC. 3. Section 5101 is added to the Civil Code, to read:

5101. A married person is not liable for any injury or damage

caused by the other spouse except in cases where he or she would be liable therefor if the marriage did not exist.

Comment. Section 5101 continues without substantive change former Section 5122(a).

406/457

Civil Code §§ 5103-5119 (chapter heading)

SEC. 4. A chapter heading is added immediately preceding Section 5103 of the Civil Code, to read:

CHAPTER 2. PROPERTY RIGHTS

406/458

Civil Code §§ 5103-5106 (article heading)

SEC. 5. An article heading is added immediately preceding Section 5103 of the Civil Code, to read:

Article 1. Interests in Property

406/459

Civil Code §§ 5107-5119 (article heading)

SEC. 6. An article heading is added immediately preceding Section 5107 of the Civil Code, to read:

Article 2. Characterization of Property

406/460 N/Z

Civil Code § 5116 (repealed)

SEC. 7. Section 5116 of the Civil Code is repealed.

~~5116. The property of the community is liable for the contracts of either spouse which are made after marriage and prior to or on or after January 1, 1975.~~

Comment. The substance of former Section 5116 is continued in Section 5120.010(a).

Civil Code § 5120 (repealed)

SEC. 8. Section 5120 of the Civil Code is repealed.

~~5120. Neither the separate property of a spouse nor the earnings of the spouse after marriage is liable for the debts of the other spouse contracted before the marriage.~~

Comment. The portion of former Section 5120 making separate property of a spouse not liable for the debts of the other spouse contracted before marriage is continued in Section 5120.020(b). The portion making earnings after marriage not liable is continued in Section 5120.010(b).

09591

Civil Code §§ 5120.005-5120.060 (added)

SEC. 9. Chapter 3 (commencing with Section 5120.005) is added to Title 8 of Part 5 of Division 4 of the Civil Code, to read:

CHAPTER 3. LIABILITY OF MARITAL PROPERTY

Article 1. General Rules of Liability

§ 5120.005. Debts

5120.005. (a) Unless the provision or context otherwise requires, as used in this chapter, "debt" means an obligation incurred by a spouse whether based on contract, tort, or otherwise.

(b) For the purposes of subdivision (a), a debt is "incurred" at the following time:

(1) In the case of a contract, at the time the contract is made.

(2) In the case of a tort, at the time the tort occurs.

(3) In other cases, at the time the obligation arises.

Comment. Subdivision (a) of Section 5120.005 is intended to facilitate drafting. Subdivision (b) makes more precise the meaning of the time a debt is incurred.

§ 5120.010. Liability of community property

5120.010. (a) Except as otherwise expressly provided by statute, the property of the community is liable for a debt of either spouse incurred before or during marriage, regardless which spouse has the management and control of the property.

(b) The earnings of a spouse during marriage are not liable for a debt of the other spouse incurred before marriage. The earnings remain not liable if they are held uncommingled in a deposit account by or in the name of the spouse, to the extent they can be traced in the manner prescribed by statute for tracing funds exempt from enforcement of a money judgment. As used in this subdivision, "deposit account" has the meaning prescribed in Section _____ of the Code of Civil Procedure, and "earnings" means compensation for personal services performed, whether as an employee or otherwise.

Comment. Subdivision (a) of Section 5120.010 continues the substance of former Section 5116 (contracts during marriage) and the implication of former Section 5122(b) (torts), and makes clear that the community property (other than earnings of the nondebtor spouse) is liable for the prenuptial contracts of the spouses. Subdivision (a) applies regardless whether the debt was incurred prior to, on, or after January 1, 1975. For rules governing liability after division of the community property, see Section 5120.050.

The introductory and concluding clauses of subdivision (a) are intended to negate the implication of language found in 1974 Cal. Stats. ch. 1206, § 1, p. 2609, that community property is liable only for the debts of the spouse having management and control. The introductory and concluding clauses make clear that the community property is liable for all debts of either spouse absent an express statutory exception. Thus community property under the management and control of one spouse pursuant to Section 5125(d) (spouse operating or managing business) or Financial Code Section 851 (one spouse bank account) remains liable for the debts of the other spouse. For an express statutory exception from liability of community property, see subdivision (b).

The first sentence of subdivision (b) continues the substance of a portion of former Section 5120 and extends it to include all debts, not just those based on contract. The second sentence codifies the rule that, for purposes of liability, earnings may not be traced through changes in form. See, e.g., Pfunder v. Goodwin, 83 Cal. App. 551, 257 P. 119 (1927). Earnings may be traced only into deposit accounts in the same manner as funds exempt from enforcement of judgments. See Code Civ. Proc. § 703.030 (tracing).

Note. Before the Commission recommends the enactment of the recommended legislation, the Commission plans to consider whether a reimbursement right between spouses should also be recommended.

§ 5120.020. Liability of separate property

5120.020. (a) The separate property of a spouse is liable for a debt of the spouse incurred before or during marriage.

(b) Except as otherwise expressly provided by statute, the separate property of a spouse is not liable for a debt of the other spouse incurred before or during marriage.

Comment. Subdivision (a) of Section 5120.020 continues the substance of a portion of former Section 5121 (contracts) and the implication of former Section 5122(b) (torts); it supersedes former Section 5123 (liability of separate property for debt secured by community property).

Subdivision (b) continues the substance of former Section 5120 (prenuptial contracts), a portion of former Section 5121 (contracts after marriage), and the implication of former Section 5122(b) (torts). For an exception to the rule of subdivision (b), see Section 5120.030 (liability for necessaries).

08352

§ 5120.030. Liability for necessaries

5120.030. (a) Subject to subdivision (b), the separate property of a spouse is liable for a debt of the other spouse incurred during marriage if:

(1) The debt was incurred for necessaries of life of the other spouse while the spouses were living together.

(2) The debt was incurred for common necessaries of life of the other spouse while the spouses were living separate and apart, unless the spouses were living separate and apart by a written agreement that waived the obligation of support.

(b) The separate property of a spouse is not subject to enforcement of a money judgment for a debt of the other spouse pursuant to subdivision (a) unless the spouse is made a judgment debtor under the judgment for the purpose of this section.

Comment. Subdivision (a)(1) of Section 5120.030 continues the substance of a portion of former Section 5121, but eliminates the implication that the necessaries must have been contracted for by either spouse. See, e.g., Credit Bureau of San Diego v. Johnson, 61 Cal. App.2d Supp. 834, 142 P.2d 963 (1943) (medical care not contracted by

either spouse). Subdivision (a)(1) is consistent with Section 5132 (support obligation while spouses live together) but does not require exhaustion of community and quasi-community property before separate property of a nondebtor spouse can be reached.

Subdivision (a)(2) is an exception to the rule of Section 5131, which abrogates the obligation of support between spouses living separate and apart by agreement, unless support is stipulated in the agreement. Nothing in subdivision (a)(2) should be deemed to limit the obligation of a spouse for support pursuant to court order in a judgment decreeing their legal separation. Subdivision (a)(2) also abolishes the "station in life" test of cases such as Wisnom v. McCarthy, 48 Cal. App. 697, 192 P. 337 (1920) (maid necessary because of economic and social position of spouses), in determining what is a necessary of life; the separate property of the nondebtor spouse is liable only for debts for the "common" necessaries of life of the other spouse while living separate and apart. Cf. Code Civ. Proc. § 723.051 (common necessaries exception to wage exemption; Ratzlaff v. Portillo, 14 Cal. App.3d 1013, 92 Cal. Rptr. 722 (1971) ("common" necessary is necessary required to sustain life).

Subdivision (b) codifies the rule that the separate property of a spouse may not be subjected to process by necessaries creditors of the other spouse unless the spouse has been made a party for the purpose of making the separate property liable. See, e.g., Evans v. Noonan, 20 Cal. App. 288, 128 P. 794 (1912); Santa Monica Bay Dist. v. Terranova, 15 Cal. App.3d 854, 93 Cal. Rptr. 538 (1971).

Note. Before the Commission recommends the enactment of the recommended legislation, the Commission plans to consider whether a reimbursement right between spouses should also be recommended.

968/667

§ 5120.040. Interspousal transfer

5120.040. A transfer of community or separate property between the spouses is subject to the Uniform Fraudulent Conveyance Act, Title 2 (commencing with Section 3439) of Part 2 of Division 4 of the Civil Code.

Comment. Section 5120.040 codifies existing law. Cf. Bailey v. Leeper, 142 Cal. App.2d 460, 298 P.2d 684 (1956) (transfer of property from husband to wife); Frankel v. Boyd, 106 Cal. 608, 614, 39 P. 939, 941 (1895) (dictum); Wikes v. Smith, 465 F.2d 1142 (1972) (bankruptcy).

§ 5120.050. Liability of property after division

5120.050. (a) Notwithstanding any other provision of this article, after division of community and quasi-community property pursuant to Section 4800:

(1) The separate property owned by a spouse at the time of the division and the property received by the spouse in the division is liable for a debt of the spouse incurred before or during marriage and the spouse is personally liable for the debt, whether or not the debt was assigned for payment by the other spouse in the division.

(2) The separate property owned by a spouse at the time of the division and the property received by the spouse in the division is not liable for a debt of the other spouse incurred before or during marriage, and the spouse is not personally liable for the debt, unless the debt was assigned for payment by the spouse in the division of the property. Nothing in this paragraph affects the liability of property for the satisfaction of a lien on the property.

(3) The separate property owned by a spouse at the time of the division and the property received by a spouse in the division is liable for a debt of the other spouse incurred before or during marriage, and the spouse is personally liable for the debt, if the debt was assigned for payment by the spouse in the division of the property. If a money judgment for the debt is entered after the division, the property is not subject to enforcement of the judgment and the judgment may not be enforced against the spouse, unless the spouse is made a judgment debtor under the judgment for the purpose of this paragraph.

(b) If the separate property owned by a spouse at the time of the division or the property received by the spouse in a division of community and quasi-community property pursuant to Section 4800 is applied to the satisfaction of a money judgment for a debt of the spouse that is assigned for payment by the other spouse in the division, the spouse has a right of reimbursement from the other spouse for the market value of the property, with interest at the legal rate, and may recover reasonable attorney's fees incurred in enforcing the right of reimbursement.

Comment. Section 5120.050 prescribes rules of liability of former community and quasi-community property and former separate property following a division of the property pursuant to a court judgment of separation, dissolution, or later division.

Subdivision (a)(1) states the rule that the rights of a creditor against the property of a debtor are not affected by assignment of the debt to the other spouse for payment pursuant to a property division. A creditor who is not paid may seek to satisfy the debt out of property of the debtor. Former law on this point was not clear. The debtor in such a case will have a right of reimbursement against the former spouse pursuant to subdivision (b).

Paragraphs (2) and (3) of subdivision (a) reverse the case law rule that a creditor may seek enforcement of a money judgment against the former community property in the hands of a nondebtor spouse after dissolution of the marriage. See, e.g., Bank of America N.T. & S.A. v. Mantz, 4 Cal.2d 322, 49 P.2d 279 (1935). Subdivision (a)(2) makes clear that former community property received by the nondebtor spouse at division is liable only if the nondebtor spouse is assigned the debt in division. In the case of a judgment entered after the division of property, the nondebtor spouse must be made a party for due process reasons. Cf. Section 5120.030(b) and Comment thereto (liability for necessaries). If the property division calls for the one spouse to pay the debt and the creditor satisfies the judgment out of property of the other spouse, the other spouse will have a right of reimbursement pursuant to subdivision (b). Subdivision (a)(2) does not affect enforceability of liens on the property. See, e.g., Kinney v. Valentyne, 15 Cal.3d 475, 541 P.2d 537, 124 Cal. Rptr. 897 (1975).

Subdivision (b) states the rule as to reimbursement where a debt is satisfied out of the property of a spouse other than the spouse to whom the debt was assigned pursuant to a property division. Former law on this point was not clear.

968/683

§ 5120.060. Liability of property after judgment of nullity

5120.060. After a judgment of nullity of a marriage, whether void or voidable, the property that would have been community property and the property that would have been the separate property of the parties had the marriage been valid is liable for the debts of the parties to the same extent as if the marriage were valid and the judgment of nullity were a judgment of dissolution, regardless whether the parties are declared to have the status of putative spouses and regardless whether the property is quasi-marital property.

Comment. Section 5120.060 is consistent with Section 4451 (judgment of nullity conclusive only as to parties to the proceeding). Former law was not clear.

Article 2. Reimbursement

[reserved]

Article 3. Transition Provisions

[reserved]

406/463 N/Z

Civil Code § 5121 (repealed)

SEC. 10. Section 5121 of the Civil Code is repealed.

~~5121. The separate property of a spouse is liable for the debts of the spouse contracted before or after the marriage of the spouse, but is not liable for the debts of the other spouse contracted after marriage; provided, that the separate property of the spouse is liable for the payment of debts contracted by either spouse for the necessaries of life pursuant to Section 5132.~~

Comment. The substance of former Section 5121 is continued in Sections 5120.020 and 5120.030.

406/465 N/Z

Civil Code § 5122 (repealed)

SEC. 11. Section 5122 of the Civil Code is repealed.

~~5122. (a) A married person is not liable for any injury or damage caused by the other spouse except in cases where he would be liable therefor if the marriage did not exist.~~

~~(b) The liability of a married person for death or injury to person or property shall be satisfied as follows:~~

~~(1) If the liability of the married person is based upon an act or omission which occurred while the married person was performing an activity for the benefit of the community, the liability shall first be satisfied from the community property and second from the separate property of the married person.~~

~~(2) If the liability of the married person is not based upon an act or omission which occurred while the married person was performing an activity for the benefit of the community, the liability shall first be satisfied from the separate property of the married person and second from the community property.~~

Comment. Subdivision (a) of former Section 5122 is continued without substantive change in Section 5101.

Subdivision (b) is superseded by Sections 5120.010 (providing no order of priority for community or separate property) and 5120.020 (providing no order of priority for community or separate property).

Note. Before the Commission recommends the enactment of the recommended legislation, the Commission plans to consider whether a reimbursement right between spouses also should be recommended.

406/466 N/Z

Civil Code § 5123 (repealed)

SEC. 12. Section 5123 of the Civil Code is repealed.

~~5123. (a) The separate property of the wife is not liable for any debt or obligation secured by a mortgage, deed of trust or other hypothecation of the community property which is executed prior to January 1, 1975, unless the wife expressly assents in writing to the liability of her separate property for such debt or obligation.~~

~~(b) The separate property of a spouse is not liable for any debt or obligation secured by a mortgage, deed of trust, or other hypothecation of the community property which is executed on or after January 1, 1975, unless the spouse expressly assents in writing to the liability of the separate property for the debt or obligation.~~

Comment. Section 5123 is not continued and is superseded by Section 5120.020. It is a form of antideficiency judgment that protects some but not all assets of a spouse for obligations secured by any community property, real or personal, residential or otherwise. It is thus inconsistent with general rules governing deficiency judgments.

10166

Civil Code §§ 5125-5128 (chapter heading)

SEC. 13. A chapter heading is added immediately preceding Section 5125 of the Civil Code, to read:

CHAPTER 4. MANAGEMENT AND CONTROL

10167

Civil Code §§ 5129-5132 (chapter heading)

SEC. 14. A chapter heading is added immediately preceding Section 5129 of the Civil Code, to read:

CHAPTER 5. SUPPORT

10168

Civil Code § 5131 (amended)

SEC. 15. Section 5131 of the Civil Code is amended to read:

5131. ~~A~~ Except as provided in Section 5120.030, a spouse is not liable for the support of the other spouse when the other spouse is living separate from the spouse by agreement unless such support is stipulated in the agreement.

Comment. Section 5131 is amended to recognize Section 5120.030(a)(2), which continues the liability of property of spouses for necessaries after separation unless expressly waived in the separation agreement.

10169

Civil Code § 5132 (amended)

SEC. 16. Section 5132 of the Civil Code is amended to read:

5132. (a) A spouse must support the other spouse while they are living together out of the separate property of the spouse ~~when~~ in the following cases:

(1) When there is no community property or quasi-community property.

(2) When the debt is one for which the separate property of the spouse is liable under Section 5120.030.

(b) For the purposes of this section, the terms "quasi-community property" and "separate property" have the meanings given those terms by Sections 4803 and 4804.

Comment. Section 5132 is amended to incorporate Section 5120.030 (liability for necessaries). Section 5132 is consistent with Section 5120.030(a)(1), but Section 5120.030(a)(1) does not require exhaustion

of community and quasi-community property before separate property of a nondebtor spouse can be reached by a third-party creditor.

Note. The amendment of Section 5132 is directed only to problems of liability of property to third-party creditors. The Commission intends to consider Section 5132 further with respect to problems of liability of property between the spouses.

09582

Civil Code §§ 5133-5137 (chapter heading)

SEC. 17. A chapter heading is added immediately preceding Section 5133 of the Civil Code, to read:

CHAPTER 6. MARRIAGE SETTLEMENT CONTRACTS

10171

Civil Code § 5138 (chapter heading)

SEC. 18. A chapter heading is added immediately preceding Section 5138 of the Civil Code, to read:

CHAPTER 7. MISCELLANEOUS PROVISIONS