Memorandum 82-3

Subject: Study F-600 - Community Property (Determination of Priorities)

At the November 1981 meeting the Commission decided to review the various problems identified in the community property studies that have been prepared for it with the objective of determining the specific problems to be given priority for study. The Commission review will relate only to the priority of various problems for future consideration by the Commission; decisions will not be made at this time with respect to how these problems should be resolved. The problems the Commission determines are to be given priority will be scheduled for extensive discussion at future meetings with a view to developing appropriate solutions to them.

Creditors' Remedies Aspects of Community Property

The first study prepared for the Commission was Professor Reppy's article, "Debt Collections From Married Californians: Problems Caused by Transmutations, Single-Spouse Management, and Invalid Marriage," now published in 18 San Diego Law Review 143 (1981). A copy of the published study is attached to Memorandum 82-2. The Commission has given this study priority because of the desirability of dealing with creditors' remedies matters in connection with the general enforcement of judgments study.

There are a number of problems raised in Professor Reppy's study that are not addressed in the Commission's recommendations on liability of marital property for debts. The Commission should review these problems with Professor Reppy's assistance in setting priorities. Briefly stated, they are:

Transmutation. Professor Reppy points out the difficulties for creditors caused by the ability of the spouses easily to transmute community property to separate property, and vice versa. Apart from whatever general attitude the law should take toward the effect of transmutation as between the spouses, Professor Reppy recommends that if the transmutation is to bind creditors it may be desirable to change the

statutes to require both a writing and recordation. The Commission considered this problem before and tentatively decided the problem should be handled under the fraudulent conveyance statute. However, in working on Civil Code Section 3440 (conclusive presumption of fraud where transfer does not result in change of possession), the Commission concluded (November 1981) that fraudulent conveyances are related to the broader subject of marital property agreements and property transmutations, and should be considered in that context. The Commission decided not to submit recommendations on Section 3440 to the Legislature at this time but to work on the problems of marital agreements and transmutations and to give the work some priority. See further discussion below, "Antenuptial and other property agreements."

Reimbursement. If community funds are used to pay a "separate" obligation of a spouse, at dissolution the community is entitled to reimbursement from the separate property of the spouse. Professor Reppy indicates a need to require payment of interest at the time of reimbursement and to overrule cases that deny reimbursement where the payment of community funds on a separate obligation was made in good faith. Where separate funds are seized by a creditor to pay a necessaries debt, Professor Reppy sees the need to overrule case law denying reimbursement from the community at dissolution of marriage. Professor Reppy also points out that there is uncertainty in the law relating to payment of community and sparate debts where the marriage is dissolved by death of a spouse; clarification of Probate Code Section 980(e) is "urgently needed."

Joint tenancy and separate-community title presumptions. Professor Reppy has suggestions for dealing with the joint tenancy-community property interrelation, including creation of a new form of title known as community property with right of survivorship (intended to decrease use of joint tenancy form of title). This problem is also addressed in the portion of Professor Bruch's study dealing with title presumptions. Professor Goda believes that among the community property technical problems, title problems and presumptions are of first importance. See Exhibit 3. Joint tenancy and title presumptions affect not only the community property study but also the Commission's probate study.

Antenuptial and other property agreements. Professor Reppy addresses the manner and extent to which spouses should by agreement be able to control the community and separate character of property, both as between themselves and as to creditors. Among other issues, he sees the need to provide a means to ensure that an unambiguous agreement will not be defeated by an oral or implied transmutation. Professor Reppy has written to us to note "the law of Mexico requires recordation if husband and wife wish to live separate in property rather than under the ordinary community regime. See Ward v. United States, 661 F.2d 226 (Ct. Cl. 1981) (oral agreement to live separate in property made by residents of Juarez who owned New Mexico business not binding on I.R.S). I believe this type of 'register your transmutation' statute is very common in civil law countries. The French Civil Code provides several regimes, but the legal regime attaches to the marriage unless the couple records the adoption of a different regime."

Other provisions. Professor Reppy in his study makes a number of other suggestions that are not dealt with in the liability of marital property recommendation. These suggestions are matters that have been deferred for discussion in connection with Professor Bruch's study; we should determine their priority as we determine priorities for matters raised in Professor Bruch's study.

Management and Control

The second study prepared for the Commission was Professor Bruch's article, "Management Powers and Duties under California's Community Property Laws," scheduled for publication in January, 1982, in UCLA Law Review. The Commission has gone through three-fourths of this study making initial policy decisions. The Minutes of the May, 1981, meeting at which this occurred are attached as Exhibit 1. With the assistance of Professor Bruch we hope to go quickly through the Minutes to determine to what extent these matters should be given priority for further work.

We need also to review the remaining one-quarter of the management and control study, commencing at page 77 of the study, to determine to what extent the remaining problems should be given priority. We are enclosing another copy of Professor Bruch's study for use at the meeting.

Division of Community Property

The third study prepared for the Commission is Professor Bruch's "The Definition and Division of Marital Property in California: Toward Parity and Simplicity" (1981). A copy of this study was sent for the December 1981 meeting; if you need another copy, please let us know. We plan to have Professor Bruch lead us through the entire study so that the Commission can set priorities.

The Commission has already made decisions with regard to two matters raised in the study--valuation of good will and enhanced earning capacity. The Commission has decided to explore the possibility of prescribing statutory standards or formulae for valuing the goodwill of a business or profession. The Commission has rejected the concept of enhanced earning capacity as a property interest but has decided to look into improving the support remedy, including the possibility of lump sum support payable in installments as well as other remedies such as reimbursement, to cure the problem of disparities in the earning capacities of the spouses at dissolution of marriage. The Commission needs to decide what priority these two areas will receive.

Federal Pensions

The Commission has submitted a recommendation that the Legislature adopt a resolution to Congress to enact federal legislation that makes clear state domestic relations laws are not preempted by federal legislation providing for pensions, insurance, and other federal benefits. This is an immediate, pressing, and real problem. If it becomes apparent that it is necessary that legislation be enacted that clarifies rules for retroactive operation of Supreme Court decisions finding state law preempted as to particular assets, or that it is necessary to take other action on this matter, the staff assumes the Commission will wish to give it top priority.

Attorney's Fees at Dissolution

Professor Reppy has written separately to point out the problem of the wife's attorney's fees at dissolution being classified as the husband's separate debt, which the husband is ordered to pay. See Exhibit 2. This problem should be scheduled for discussion along with the others.

Simplification of Dispute Resolution Process

Professor Goda has written that for those who do not have wealth, the time and expense of dissolution litigation is prohibitive, and the Commission should consider providing non-judicial dispute resolution processes. Exhibit 3. The staff notes that dissatisfaction with the existing system is not limited to problems it causes for marriages that do not have substantial assets. From a recently published interview with Placer County Superior Court Judge Richard M. Sims:

> On legislation he would like to see enacted, Judge Sims said that "the law of marital dissolutions and division of property has become absurdly complex. The result has been to saddle ordinary folks with prohibitive costs of divorce and to increase unacceptably the risk of malpractice for attorneys." He believes "the Legislature must step in to simplify rules applicable to retirement benefits, professional goodwill, and valuation of closely held corporations."

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

EXHIBIT 1

Detailed Minutes of May 14-16, 1981, Meeting
Relating to Community Property

The Commission considered Memorandum 81-18, Memorandum 80-90, and the Background Study attached to Memorandum 80-90, relating to community property. The Commission made the following decisions concerning the matters considered.

Duty of good faith. The Commission discussed the relation of the duty of good faith in the management of community property to case law statements of a fiduciary duty imposed at a time when the husband had the management and control of the community property. The Commission adopted language defining the duty of good faith based on a draft of the Uniform Marital Property Act: the duty of good faith includes "the obligation to act in a manner which a spouse reasonably believes to be in or not opposed to the best interests of the family." The Comment should not make reference to the case law statements of a fiduciary duty but should note that the good faith requirement is not a fiduciary duty as used in an investment context but is a duty that arises out of the confidential relationship of the spouses.

Duty to inform. The Commission adopted the language of Section 2 of the draft Uniform Marital Property Act that a spouse has the obligation of making full and timely disclosure of property and debts. This obligation may be enforced by a petition for an accounting. The court has flexibility in fashioning an accounting to the extent the court determines is appropriate under the circumstances of the particular case. The Comment should note that one of the means available to the court is to require a spouse to make available to the other spouse sufficient information to enable the other spouse to determine the nature and extent of the property and debts.

Gifts of community property. The rule on the extent to which a spouse can make a gift of community property, set out in Section 5125.120, should be subject to the general duty of good faith as well.

Sale or encumbrance of household goods. The Commission decided to eliminate the requirement of consent, whether written or express or implied, for the sale of household goods by one spouse. However, both

spouses must join in "the creation of any security interest other than a purchase money security interest" in household goods.

Disposition of community property business. The Commission decided not to impose a joinder or consent requirement for disposition of a community property business. The staff should check to see why the Uniform Marital Property draft imposes a joinder requirement only where both spouses are involved in the business.

Disposition of community real property. The Commission discussed the problem that arises under the requirement that both spouses join in a disposition of community real property in the case of property that stands in the name of only one spouse. Among the suggested solutions were (1) keeping existing law that disposition by the one spouse is voidable for a period of one year, (2) allowing the non-joining spouse to void the disposition as to a one-half interest, (3) applying the joinder rule only to the family residence as opposed to business property, and (4) allowing the non-joining spouse to have the spouse's name added to title and protecting a bona fide purchaser if the non-joining spouse fails to do so. The Commission deferred decision on this matter for later discussion in connection with partition and other remedies available between the spouses; problems with the definition of community real property and the case of Mitchell v. American Reserve Ins. Co. should also be raised at that time. In connection with the later discussion the staff should analyze the approach of the Uniform Marital Property Act and should compare the remedies available where one spouse makes a transfer of a substantial community property business asset without the joinder or consent of the other spouse.

Tenancy in common property. Where community property that is not divided at dissolution becomes tenancy in common property by operation of law, the Commission felt that no special duty or standard of care other than the duty or standard applicable to tenants in common generally should apply. The question whether the court should retain jurisdiction to later divide the omitted assets is to be examined in connection with the Commission's consideration of the jurisdiction of the court in dissolution cases.

Joinder for exercise of options under pension or annuity plans. The Commission discussed the extent to which it would be desirable or feasible to require joinder of both spouses for exercise of options under pension plans. There was a consensus on the Commission that if an

option is elected at the time of retirement, both spouses should join. Whether there should be a statutorily prescribed option in case of failure of joinder was discussed. The Commission felt that it needed more information about the extent to which it would be feasible to regulate pension plans so as to protect the rights of spouses, and requested that expert opinion by actuaries (Mr. Gabrielson volunteered to bring an actuary to the meeting) and representatives of public retirement funds be presented to it.

Joinder requirement for life insurance beneficiary designations. The Commission decided that in the case of a community property life insurance policy (as opposed to a business or key person policy), if a spouse selects a beneficiary other than the other spouse both spouses must join in the beneficiary designation, except that one spouse alone can specify a beneficiary for one-half of the proceeds. In drafting implementing language for this concept care should be taken to protect insurance companies that have relied upon apparently valid beneficiary designations, for example by certification that the insured is not married or that the policy was purchased with separate property. Existing provisions protecting insurance companies in reliance on the beneficiary designation should be examined.

Joinder for contracts of surety, guaranty, or indemnity. A limitation on the ability of one spouse to obligate the community for surety contracts should be drafted in the form of a reimbursement right (on a gift theory) rather in the form of a joinder or consent requirement.

Post-separation earnings as separate or community property. A discussion of this matter was deferred until the second portion of Professor Bruch's study dealing with the definition of community property is available.

Liability of property of second marriage for support of children or spouse of first marriage. Civil Code Sections 199, 5127.5, and 5127.6, relating to a stepparent's support obligation should be repealed and be replaced by a clear statement of the law. The law should be that both a child who a person is obligated to support and a former spouse who a person is obligated to support can reach the separate property of the person and all the community property of a subsequent marriage except the earnings of the person's spouse. The Comment should note that this scheme is not intended to affect any consideration of the earnings of the person's spouse under AFDC regulations. In this connection it

should be made clear that Civil Code Section 4807 applies only to a current marriage. The Commission noted that this scheme imposes essentially the same liability as for a prenuptial creditor of the person. The State Bar has suggested that a prenuptial creditor should be able to reach only one-half the community property. If the Commission decides to change the rule as to prenuptial creditors it will at that time reexamine the rule as to liability to stepchildren and former spouses for support.

Interspousal torts. Rather than an order for priority of payment of interspousal torts (first separate property of the tortfeasor, then community property) as provided in Civil Code Section 5113, the statute or Comment should make clear that if payment is made out of community property, one dollar of community property satisfies only fifty cents of the debt, whereas one dollar of separate property satisfies one dollar of the debt.

Transmutation of personal property. In the case of oral transmutations of personal property or gifts between spouses the following rules should apply. There should be a presumption that, regardless of the oral transmutation or gift, a household type item is community property and a personal type item is separate property. Overriding these presumptions should be a presumption that large or substantial items in value, given the circumstances of the particular marriage, are community property. These presumptions affect the burden of proof and should apply regardless whether the source of the funds by which the items were acquired was separate or community property.

Gift presumption in acquisition of real property. Gift presumptions in the acquisition of real property should be abolished. The character of real property acquired with community property or separate property or both should be presumed to be community or separate or both in proportion to the source of the funds contributed for acquisition. This presumption affects the burden of proof and is rebuttable by evidence of a contrary intent, but the manner of taking title is not evidence of intent. These rules do not apply to subsequent changes in title nor do they apply to subsequent contributions to the property whether in the form of mortgage or tax payments, improvements, etc. These matters, and the question of the proportion of the property available to creditors and to each of the parties at dissolution of marriage and at death will

be dealt with separately. One suggestion discussed extensively in this regard, but on which no decision was made, was that all appreciation of the property be community, regardless of the source of funds for mortgage payments, or other payments that affect the property.

Oral transmutation where there is antenuptial agreement. The staff should examine the rule of Civil Code Section 1698(b) that a written agreement may be modified by oral agreement to the extent the oral agreement is executed, in light of its application to oral transmutations of community property. Two possible approaches where there is an antenuptial agreement are (1) require that "execution" be accomplished by a deed or (2) require written modification where the antenuptial agreement states that it may be modified only in writing.

Repeal of Civil Code Sections 5114-5115 and 5133-5135. The Civil Code provisions relating to written and recorded statements of separate or community property and marriage settlements should be repealed, subject to staff research on possible protections for creditors' rights intended to be effectuated by these provisions.

Commingled property. In cases where community and separate funds are commingled so that the character of property acquired is mixed, there should be a presumption that the property is community. This affects the burden of proof and the presumption can be rebutted by evidence of contemporaneous documentation as to the character of the property. If commingled property is invested in a number of assets and the proportions of community and separate funds that were commingled is determined, at dissolution the community should have first pick as to which investments were made with the community funds and which were made with separate funds. If commingled property is used for living expenses, or if community property is used for living expenses, the Commission discussed a number of approaches to making a fair allocation so that the community is not impoverished to the benefit of separate property, including proportionate interests in property and lump-sum support and family allowance awards out of separate property. The Commission deferred decisions in this area until the final portion of Professor Bruch's study is available dealing with characterizing income of separate property as community.

Interspousal support obligations. Discussion of this matter was deferred for later discussion in connection with the characterization of post-separation earnings.

Personal injury damages awarded to tort victim. Unless the court at the time of making an award of damages specificies the amount that is for pain and suffering (separate property) and the amount that is for lost earnings (community property): (1) During marriage the damages are presumed to be separate and are subject to management by the injured party; the proportion of separate and community interests in the award would be determined only if necessary to ascertain the rights of creditors, and would be subject to the presumption of separate property. (2) At dissolution the property would be awarded to the injured spouse except that the court can make an equitable division taking into account the factors prescribed in Civil Code Section 4800(c).

Exhibit 2

Duke University
DURHAM
NORTH CAROLINA

SCHOOL OF LAW

September 8, 1981

POSTAL CODE 27706

Mr. Nat Sterling, Esquire
California Law Revision Commission
4000 Middlefield Road
Palo Alto, California 94306

Dear Nat:

I am in the process of preparing commentary on Carol Bruch's study. Meanwhile, I respond by this letter to your inquiry as to whether there are any other topics related to community property that should come before the Commission.

I feel legislation is needed to correct a long line of cases that ought to have ended with the enactment in 1970 of the equal division at divorce statute (Civ. Code sec. 4800) but, incredibly, still lives on. E.g., Marriage of Barnert, 85 Cal. App. 3d 413, 149 Cal. Rptr. 616 (1978). I refer to the remarkable practice of divorce courts in making a division of the community of ordering the husband to pay wife's attorney's fees at divorce and then classifying the debt as husband's separate debt. Under no conceivable theory is such an obligation husband's separate debt. Under the "benefit" test, it is obvious that the wife benefits more than the husband from the paying of fees owed her attorney. The debt plainly should be classified as a community debt. The attorneys fees should be paid before the community is divided 50-50.

The post-1970 caselaw treating wife's attorney's fees as an exception to equal division can only be explained as lingering "sexism." The courts do not like equal division and seek for some device to give the female spouse more than 50% at divorce.

The contention in Marriage of Folb, 53 Cal. App. 3d 862, 126 Cal. Rptr. 306 (1975), that Civ. Code sec. 4370 calls for treating the wife's attorney's fee as husband's separate debt is unconvincing. That statute has nothing to do with characterization of the debt as separate or community.

In any event, since the courts rely on sec. 4370 in perpetuating their attempts to defeat equal division, the remedy is an amendment to that section. One approach would be to add this language: "An award of attorneys' fees at dissolution shall be treated as a community debt and paid from community funds before the community property is divided pursuant to section 4800."

Until something like this is enacted women will continue to be "more equal" at divorce than men. Since there no longer is any anti-woman bias in California's community property law to "offset" by such female favoritism at divorce, the existing practice is indefensible.

Cordially,

William A. Reppy, Jr.
Professor of Law

WAR:paw

Exhibit 3

THE UNIVERSITY OF SANTA CLARA • CALIFORNIA • 95053

SCHOOL OF LAW

984-4286 or
4443

December 8, 1981

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

Dear Mr. Sterling:

Nat, it was a pleasure to meet you on Friday, December 4. I am sorry that I could not stay to hear the rest of the discusson on Community Property issues.

Although your letter of transmittal of Professor Bruch's study last summer asked for comments by December 10 for your January meeting, I gathered from the meeting last Friday that you will rather discuss what direction you intend to take rather than specific points at issue. I am taking the occasion to send this letter simply to indicate my interests as one of your "consumers." I understand that this will not get to you by Dec. 10 but I suppose that I am putting some of my own ideas into a written form.

It seems to me that your basic problem is to decide whether you want to revise the family law system or simply make technical changes in the handling of Community Property. If you decide the latter, then your only problem is to decide the importance of debt issues, reimbursement, the place of the family expense presumption, presumptions in general and so on. To put it briefly, the title problems and presumptions would seem to me to be of first importance should your interests be limited to technical changes.

However, if your real interests are to revise the family law system, and I think that is to be implied, then I think the issues of priorities are far more complex. I was surprised by the suggestions of going to an equitable division of property. That discussion brought up the problems mentioned by Dr. Weitzman. If most couples have little community property, then the issue is not even of an equitable division of community property but of the family law system as such.

Let me simply mention my "druthers" here, for whatever those are worth. For those who have wealth, made up of enough community property to make 1/2 and 1/2 division fair, it seems to me that the

present system is as good as any other. For those who do not have wealth, the need to pay attorneys, the cost of litigation and time, all the frictions in a non-frictionless system, seem to indicate a need not just for equitable division of property but for an elimination of an expensive court system to handle their problems.

It would be my opinion that some sort of panel which was basically non-judicial should handle custody, alimony and property problems. I am obviously assuming that this would be less expensive. I would also hope that it might function better than the conciliation court and might be able to function indirectly as an aid to the people before it to look at their problems and solve them together.

Enough--I don't have the time to flesh this out. But I do want to get before you my opinion that I think you are dealing with issues that are far larger than those relating to the division of community property.

With thanks,

Sincerely,

Paul J. Goda, S.J.

Paul J. Goda, S.J.

PJG:jw