

Kern County School of Law

COMMUNITY PROPERTY

FINAL EXAMINATION

Fall 2020

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Instructions:

This exam consists of 3 essay questions. You will be given four (4) hours to complete the examination.

Your answer should demonstrate your ability to analyze the facts in the question, to tell the difference between material facts and immaterial facts, and to discern the points of law and facts upon which the case turns. Your answer should show that you know and understand the pertinent principles and theories of law, their qualifications and limitations, and their relationships to each other. Your answer should evidence your ability to apply the law to the given facts and to reason in a logical, lawyer-like manner from the premises you adopt to a sound conclusion. Do not merely show that you remember legal principles; instead try to demonstrate your proficiency in using and applying them. If your answer contains only a statement of your conclusions, you will receive little credit. State fully the reasons that support your conclusions and discuss all points thoroughly. Your answer should be complete, but you should not volunteer information or discuss legal doctrines that are not pertinent to the solution of the problem.

Essay Question Number 1

Wanda is a California resident and was a governmental liaison for the county in which she worked for many years. She retired in 2010, which included a hefty county pension, a defined benefit plan. As part of her retirement plan, Wanda received her pension in both a lump sum and in monthly installments. She had these payments deposited into an account, which she opened in her name at Lucky Strike Bank along with the lump sum payment (herein "Wanda's Account"). In 2015, Wanda met Harry, also a California resident. Harry worked in a local hardware store. Prior to marriage, Harry contributed to a 401(k) plan, which was a defined contribution plan that was funded based on a percentage of his wages each paycheck. Wanda and Harry married two years later, in 2017. Because she wanted something to do, Wanda then got a job working as a security guard at a local college. She deposited all of her earnings into Wanda's Account. During marriage, Harry opened his own account in his name at Lucky Strike Bank (herein "Harry's Account") and during marriage he deposited his salary from the store into this account. Wanda and Harry paid all their household expenses from Wanda's Account. These expenses included the payment of a \$50,000 Mercedes. In 2019, Wanda filed for divorce from Harry and they separated. The Mercedes is now worth \$35,000. Just after the date of separation Harry had \$40,000 in Harry's Account and took \$20,000 for himself. What claims can Wanda and Harry make as to any separate property reimbursement claims? Answer according to California law.

Essay Question Number 2

Assume the facts as stated in Question Number 1. At Harry and Wanda's wedding, Wanda's mom gifted a fully paid townhouse worth \$300,000 and put it in Wanda's and Harry's name. During their marriage, Wanda and Harry took out a \$100,000 loan secured by a deed of trust against the townhouse. During marriage, Wanda and Harry made payments on the mortgage for the townhouse in the amount of \$50,000 exclusively from Harry's Account. The townhouse was worth \$450,000 on the date of separation. During marriage, Wanda and Harry made \$20,000 worth of improvements from their community property from Wanda's Account but these improvements did not substantially improve the value of the home. After they separated, Wanda was the only one who could afford the mortgage payments for the townhouse. She also had the exclusive use and possession of the townhouse and faithfully made all of the mortgage payments until Harry wanted it sold. When she realized that Harry wanted the townhouse sold, she failed to make the \$1,500 mortgage payments for the six months prior to it being sold. What are Wanda's and Harry's rights and liabilities, if any, regarding their community and separate property claims to the townhouse? Answer according to California law.

Essay Question Number 3

Assume the facts as stated in Question Number 1. Just prior to marriage, Harry started a new business creating widgets with \$50,000 of his own money and, because he needed it, with Wanda's help with managing the accounting, for which he paid her. During their marriage, the widget company was very successful because of Harry's tireless efforts. Because of that hard work the widget company had a value of \$5,000,000 as of the date of their separation. Harry was vastly underpaid during marriage because he wanted to put as much money back into the business so that it was successful. Unfortunately, during marriage, Harry was injured when a driver, Sonic, negligently struck him with his car causing serious injuries. Although Harry can still work, Harry is not expected to fully recover until he undergoes several more surgeries. Fortunately, Wanda and Harry, in addition to their other retirement plans, had also purchased an insurance policy in the event of just such an accident. Before Harry and Wanda could settle the case or take advantage of the disability policy, they had to take out a \$100,000 loan to cover Harry's medical expenses. After the date of separation, Harry also settled his claim against Sonic for \$3,000,000, most of it revolving around a life care plan for future medical expenses for Harry. What are Wanda's and Harry's right and liabilities regarding the division of the personal injury settlement and the disability insurance? Answer according to California law.

MODEL ANSWER OUTLINE (Essay Question Number 1)

1. Community Property Presumptions

- a. California is a community property (CP) state.
- b. All property acquired during marriage is CP.
 - i. All Wages are CP
 - ii. The labor of either spouse during marriage is CP.
- c. Separate property
 - i. Property acquired before or after marriage is SP.
 - ii. Property acquired during marriage by either spouse through gift, will, or inheritance is SP.
 - iii. Property acquired from SP funds is SP.
 - iv. Profits, rents, and issue of SP retains its SP character.
- d. Equal Division
 - i. Courts are statutorily required to make an equal division of CP
 - ii. If possible, the equal division is to be made "to the penny"

2. Retirement Plans

- a. General Rule
 - i. The CP and SP presumptions apply to retirement contributions made before, during and after marriage
 - ii. In order to effect an equal division of retirement plans, courts have the discretion to apply:
 1. Time Rule, which is the amount in plan divided by the years of marriage as a percentage of CP ownership
 2. In-Kind Division. Courts may make an in-kind division if the value of the retirement plan is known. This typically requires expert testimony.
- b. Wanda's Pension
 - i. Wanda is entitled to her SP contributions prior to marriage plus any interest resulting from that SP interest.
 - ii. Since this is a defined benefit plan, if an expert cannot value the actuarial value of the plan or the parties cannot agree to its value to value it in-kind, the court must divide it by the Time Rule.
 - iii. In this case, assuming Wanda has not commingled her retirement plan with CP funds, which does not appear

to be the case, the entirety of the plan should be confirmed to her as her SP because she earned all of it prior to marriage.

c. Harry's 401(k):

i. CP Wages. Wages earned during marriage are CP.

ii. Since this is a defined contribution plan, which was funded from Harry's CP wages, that portion of the plan that was funded during marriage is CP

iii. SP Wages. All earnings of a spouse after the DOS are SP. Any earnings by Harry after the DOS should be confirmed to him as his SP

iv. Analysis.

1. In-Kind Division. Harry can hire an expert to determine all amounts contributed and any interest earned during marriage and after marriage to determine a CP value.

2. Time-Rule. Otherwise, the court will have to divide the plan by the time rule and Harry will need to pay someone to have a QDRO entered by the court and sent to the plan administrator to divide the plan once Harry reaches retirement age or when distributions are made.

d. Bank Accounts

i. Tracing

1. If SP has not been commingled, then the party asserting a SP claim must initially show its SP character and then the burden falls on the party claiming a CP character to show that the asset was commingled.

2. If SP has been commingled with CP, the burden is on the spouse asserting a SP character of that asset to overcome the CP presumption through an adequate tracing back to a SP source.

ii. Wanda's Account

1. SP earnings. All of Wanda's SP earnings that went into this account are her SP.

2. Commingled Account. Because Wanda began depositing her wages during marriage into this account, it became a commingled account.

3. As a result, Wanda bears the burden of performing an adequate tracing based on competent documentary evidence tracing what is in that account to her SP.
 4. Family Expense Rule. As part of the tracing, Wanda will need to determine whether and what family expenses were paid from this account. She will also need to show that the SP funds in this account were not exhausted in paying these funds.
 5. Presumptive Gifts. Any family expenses paid with CP are presumed to be gifts to the community unless there is a written agreement to the contrary.
 6. Direct Tracing. When performing this tracing, Wanda must do so through a direct tracing and cannot rely on what is called the Exhaustion Method/Recapitulation/Family Expense Tracing method.
 7. CP Presumptions. If there are any documentary gaps in the tracing done by Wanda, she should give all benefits of the doubts to the CP presumption.
- iii. Harry's Account.
1. Opened During Marriage. Any account opened during marriage, even one in one spouse's name, is presumptively CP.
 2. CP Wages. Since all of Harry's Account was funded with his wages, all amounts in this account are presumptively CP and should be divided equally between the parties.
 3. Since Harry took \$20,000 from this account, he should be charged with this amount as a pre-distribution of CP in the final division of the community estate.
- e. Mercedes
- i. Parties are entitled to reimbursements under section 2640 for SP contributions during marriage.
 - ii. The party claiming the SP reimbursement under section 2640 must properly trace the SP funds used
 1. Briefly restate tracing Rules
 2. Documentary evidence needed

3. SP claimant gets value of SP claim up to the value of the asset
4. Application of tracing rules to facts
 - a. Direct Tracing is most appropriate method because of discreteness of transaction
 - b. In this case, if Wanda can properly trace the payment of the Mercedes to her SP funds, she is entitled to an amount no greater than \$35,000, which is its current value

MODEL ANSWER OUTLINE (Essay Question Number 2)

3. Townhouse – Gift Issue
 - a. Title presumption under 662 of the California Evidence Code does not apply between spouses during marriage
 - b. Section 852 of the California Family Code trumps Section 662 for SP to become CP
 - i. Must be a valid transmutation (no magic language needed)
 - ii. Single writing
 - iii. Express declaration
 - iv. No consideration needed
 - c. It is a factual issue as to whether it was a SP gift or a CP gift
4. Townhouse – Reimbursement Issue
 - a. Reimbursement rights of SP to Wanda
 - i. SP gets reimbursement of value of property at time of gift plus any appreciation
 - ii. Intent of Lender Doctrine –
 1. Loans taken out during marriage are presumptively CP unless Wanda can show it relied primarily on her SP
 2. Moore/Marsden rule applies for principal payments made on townhouse if payments were made from a CP source
 3. No facts to suggest this was anything but a CP loan

- iii. Moore-Marsden analysis applied to determine any CP interest in principal payments made to reduce principal of townhouse.
 - b. If Townhouse is CP
 - i. Equal division of net proceeds at time of trial to both parties after sale of home
 - ii. Or appraised value with party receiving the townhouse charged with half its net value
- 5. Character of Expenses Paid During Marriage
 - a. 2640 Reimbursements to reimburse the community for improvements made during marriage.
 - i. The \$20,000 is the type of expense under which 2640 applies.
 - ii. 2640 only applies if the improvement improved the value of the home.
 - b. Family Expense Rule –
 - i. CP expenses are presumed to be paid from CP funds
 - ii. CP Expenses that are paid from SP funds are presumed to be a gift unless there is a writing between the parties preserving the SP reimbursement right.
 - c. Tracing Rules
 - i. Direct Tracing
 - ii. Exhaustion Method (family expense rule)
 - iii. Recapitulation (not-preferred)
 - iv. Application of tracing rules to facts
- 6. Character of Post-Separation Expenses
 - a. Epstein credits are credits given to a party who makes post-separation payment for CP debts
 - b. The paying party is credited with half the value of the payments
 - c. The party claiming the credit must produce evidence of payments made
 - d. Exception: parties who have the exclusive use and possession of a CP asset, such as a residence, are not entitled to reimbursement if the value of those payments is approximately equal to the value of the reimbursement claim.
 - i. Further Exception:
 - 1. Under marriage of Watts,

- a. If Wanda underpays for the townhouse, Harry may be entitled to Watts charges for the amount of the underpayment.
 - b. If Wanda overpays for the townhouse, Wanda may be entitled to Watts charges for the amount of the overpayment.
 - e. Because Wanda has the exclusive use and possession of the townhouse and is paying the fair rental value of the property, Watts charges for either party are inapplicable.
7. Deficient Mortgage Payments
- a. Assuming the townhouse is a CP asset
 - b. A party who assumes exclusive use and possession of a CP asset post-separation is solely responsible for any liens and other payment necessary to maintain that asset.
 - c. In this case, Wanda failed to make the \$1,500 mortgage payments for six months.
 - d. Harry is entitled to the reimbursement from Wanda's portion of the net sale proceeds because, otherwise, he will be required to pay half of Wanda's obligations to maintain the residence.

MODEL ANSWER OUTLINE (Essay Question Number 3)

1. Widget Company

a. Characterization

- i. Separate Property of Harry based on the fact that it was started prior to marriage with separate property funds and was due to his efforts.
- ii. Possible contract/partnership claim under a *Marvin*-action based under a possible partnership theory. But, this is unlikely given that Wanda was paid for her work.

b. Division at Separation

- i. Pereira Analysis. Based on the personal efforts of a spouse. The community gets a reimbursement by subtracting the value at the date of separation from the value at the date of marriage, less a reasonable rate of return with the community getting the remainder.

- ii. Van Camp Analysis. Whether the community was properly compensated. In this case, the facts are not there but the court will need to determine Harry's reasonable compensation less family expenses to determine whether the community has a reimbursement right.

2. Personal Injury Settlements

- a. Personal injury awards
 - i. Damages resulting from injuries suffered during marriage are CP
 - ii. Presumptively awarded to the injured party
 - iii. Based on facts and circumstances, court has discretion to award a portion to non-injured spouse
 - iv. But no less than half to the injured spouse
- b. Even though the settlement was made post-separation, this does not defeat the presumptively CP nature of any damages
- c. Analysis of facts to law. The disability here suggests the injury was severe indicating that all or most of the award should go to Harry.

3. Proceeds From Disability Insurance

- a. Proceeds from a Disability Insurance Policy
 - i. Disability insurance is CP if the purpose it was taken out during marriage was to replace CP earnings
 - ii. If true disability policy, then the amounts will be confirmed to injured party as his/her SP
 - iii. Analysis: The parties had sufficient retirement plans already in place and the facts clearly suggest this policy was taken out for the express purpose of covering Hottie in the event of an accident and so should be confirmed to him as his SP.

4. Medical Loan

- a. Debts acquired during marriage are CP, including personal injury settlements.
- b. As a threshold matter, the court will be required to equally split the \$100,000 debt between Harry and Wanda unless there are equitable factors that would allow it to make an alternate division so long as Harry gets no less than half the award.
- c. Equitable Division. Since a court has discretion to make an equitable division of personal injury damages, if the court awards the entirety to Harry, it would be equitable for the court

to reduce that award by \$100,000 for medical expenses that are only Harry's.

1)

Question 1:

1. When making the final property division in Harry and Wanda's dissolution proceeding, how should the court characterize the following items?

California is a Community Property state. There is a presumption that all property acquired during marriage is Community Property (CP) under Family Code 760. In California, all property acquired during marriage is community property. Any property that is determined to be CP will be equally divided between the parties. Separate Property (SP) is property acquired before marriage or after permanent separation, or acquired by gift, bequest, devise or descent with rents, issues, and profits thereon under Family Code 770. In this case, the ownership of each of the assets will depend on whether the CP presumption controls, or the actions of the parties or some other presumptions have changed the character of the property.

The facts indicate that Wanda and Harry married 2017. Absent any other facts, the marriage is presumed to be a valid marriage. Wanda filed for divorce from Harry and they separated in 2019, which is our date of separation (DOS).

a. Wanda's Pension?

Employee retiree benefits accumulated during marriage, even if not vested at the time of divorce, are deemed to be community property. If the retirement benefits have not vested at the time of divorce, the time proration rule is applied. Under the time rule, the community is entitled to deferred earnings obtained by the employee spouse during marriage divided by the total number of years employed. The employee spouse is entitled, as separate property, to deferred earnings before marriage and after the date of separation divided by the total number of years employed.

In this instance, the facts indicate that Wanda was a governmental liaison for the county for many years, but retired in 2010. As a result of her retirement, Wanda received her pension in both a lump sum and in monthly installments. Wanda and Harry did not marry until 2017, 7 years after Wanda retired. Therefore, Wanda's employee retiree benefits were not accumulated during marriage.

Wanda's pension (lump sum and monthly installments) is Wanda's SP.

b. Wanda's Lucky Strike Bank Account?

Source-Separate Property

Separate property is all property owned before marriage and that acquired afterwards by gift, bequest devise or descent, together with the rents, issues, and profits thereof.

Wanda opened the account at Lucky Strike Bank in her name years prior to her marriage to Harry. As discussed above, Wanda received her pension in both lump sum and in monthly installments and these payments were deposited into her Lucky Strike account. Subsequent to her marriage to Harry, Wanda continue to receive the monthly installment payments into her account.

Therefore, Wanda will contend that her account is SP.

Commingled Funds

When assets have been commingled in such a manner that each source cannot be identified, the commingled assets are presumptively CP.

Here, Harry will contend that Wanda's account should be considered CP because Wanda deposited all of her earnings from her job as a security guard into her Lucky Strike Bank account. Wanda, after her marriage to Harry, obtained a job and acquired earnings. All earnings acquired by a married person during the marriage is CP.

Commingled Bank Accounts- The Source Rule

The mere fact separate funds were commingled with community funds does not automatically transform the funds into CP. The burden of proof is on the spouse attempting to recover the SP to show that each asset was acquired with SP. Such as that CP was not available, so it must be from the SP funds (recapitulation). There are two methods that can be used to overcome the presumption of CP: exhaustion and/or direct tracing.

Exhaustion

If at the time the property was acquired the value of the property exceeded the total value of CP, the property is presumed sp. (All of the CP funds have been exhausted from the account.) The family expense presumption states that if there are CP funds to pay family expenses, there is a presumption that expenditures for family expenses were made with CP funds.

The facts indicate that Wanda and Harry Paid all of their household expenses from Wanda's account. Wanda will contend that she did not earn much money as a security guard at a local

college; therefore, Wanda's earnings barely covered their family expenses and also had to use her SP pension payments to pay all expenses. As a result, Wanda will argue that the remaining funds in the account are her SP pension payments.

The court will mostly find that Wanda's account is SP.

c. Harry's 401(k) Account?

Retirement Accounts

Employee retiree benefits accumulated during marriage, even if not vested at the time of divorce, are deemed to be community property. If the retirement benefits have not vested at the time of divorce, the time proration rule is applied. Under the time rule, the community is entitled to deferred earnings obtained by the employee spouse during marriage divided by the total number of years employed. The employee spouse is entitled, as separate property, to deferred earnings before marriage and after the date of separation divided by the total number of years employed.

Here, the facts indicate that prior to marriage Harry contributed to a 401(k) plan, which was a defined contribution plan that was funded based on a percentage of his wages each paycheck. Harry will argue that he did not contribute to the 401(k) plan after he married Wanda and his 401(k) plan should be considered SP. Wanda will contend that the 401(k) plan is CP. Wanda can request discovery on all transactions from the onset of the 401(k) plan until the DOS. If Wanda can show Harry contributed to the 401(k) plan during marriage, those funds would be considered CP and would be subject to the time proration rule.

Unless evidence is shown that Harry contributed to the 401(k) plan from the DOM to the DOS, Harry's 401(k) will be considered SP.

d. Harry's Lucky Strike Bank Account?

CP Presumption

All property, real or personal, wherever situated, acquired by a married person during the marriage while domiciled in CA is CP.

Under the CP presumption, Harry's bank account would be community property. Although the account is in Harry's name, Harry opened the account during marriage. Further, Harry deposited his salary from the store into his account during marriage. The money earned during marriage is

considered CP. Absent a waiver of Wanda's rights to the community funds, Harry's account will be considered CP.

Wanda and Harry will be entitled to the equal share of the funds in the account.

2. When making the final property division in Harry and Wanda's dissolution proceeding, will the court allow reimbursement for the following items?

a. Purchase price of the Mercedes?

Under the general presumption, the Mercedes is CP as it was acquired during the marriage. In order to rebut the presumption that the Mercedes is CP, Wanda will contend that the car was purchased using her SP bank account funds. Wanda will claim an interest in the car because it was purchased with funds solely from her separate account, as the family expenses had depleted the CP earnings.

Gift to Community

Personal gifts are gifts between spouses, such as clothing, jewelry, or other tangible articles of personal nature that is used solely by the spouse to whom the gift is made and that is not substantial in value taking into account the circumstances of marriage. If the gift is substantial in value, it will be presumed CP. Transmutation is triggered when source of gift is change. After 1985, a transmutation requires a writing, signed by the spouse whose interest was adversely affected. Further, persona

Harry will rebut that separate property funds were used by arguing that Wanda made a gift to the community. A \$50,000 car is substantial and is likely not a gift. The facts don't indicate that there was a writing. However, since the Mercedes was acquired during marriage, the CP presumption should apply. Wanda may have a claim for reimbursement if SP funds were used however.

Reimbursement

A spouse who contributes SP to a community property asset is entitled to a dollar for dollar reimbursement upon dissolution.

Wanda will argue that she should receive \$50,000 for the Mercedes as her SP funds were used. Wanda will contend that her earnings were not sufficient to cover their living expenses in addition to an expensive car and had to use her SP funds to pay for it.

The car has lowered in value; therefore, she may not be reimbursed the full \$50,000. The court may allow Wanda to keep the car as her SP.

b. Household expenses?

A spouse who contributes SP to a community property asset is entitled to a dollar for dollar reimbursement upon dissolution. However, personal and living expenses will not be reimbursed.

Wanda will not receive reimbursement for the household expenses paid from her bank account.

c. \$20,000 Harry retrieved from the account?

Fiduciary Duties

The general rule is that spouses are subject to fiduciary duties that arise from their confidential relationship, which imposes a duty of the highest good faith and fair dealing with each other. Each spouse owes fiduciary duties to each other from the DOS to the date of distribution of assets to all activities that affect the assets and liabilities of the other party. A spouse has a claim against the other spouse for any breach of the fiduciary duty that results in impairment to the claimant spouse's current undivided one-half interest in the community estate. A non-breaching party may be entitled to an offsetting payment or punitive damages.

Here, after the date of separation Harry withdrew \$20,00 from the CP account in his name. Wanda will be entitled to one half or an amount equal to one half of any asset undisclosed or transferred in breach of the fiduciary duty, plus attorneys fees and court costs for the breach. Further, if Wanda can prove by clear and convincing evidence that Harry breached his duty with fraud, malice, or oppression, she may be able to recover punitive damages. Punitive damages may include an award of 100% of any asset undisclosed or transferred in breach of the fiduciary duty. Wanda may be entitled to the entire \$20,000.

END OF EXAM

2)

In general: *California is a community law state. Under community law, a community is formed at the solemnization of the marriage, and the community takes ownership various items acquired during marriage. The court will presume that all items acquired during marriage are community property, and the separate property proponent has the burden of tracing the source of funds or otherwise proving to the court that an item acquired during marriage is separate property. Items that are purchased using separate property funds or that are acquired without community effort through inheritance, gift, or profits issuing from separate property investments remain separate property. Labor is a community property investment, and thus wages is the community property reward for that investment.*

What is the character of the townhouse the day after marriage? *Gifts received during marriage are separate property of the person receiving the gift. Where a gift is given to both parties, the classification as separate property or community property results in similar but different results. The difference between these two forms becomes relevant upon the death of the parties. Here, Wanda's mom indicated the recipient of the gift by the manner in which she wrote the deed. Because the deed was originated in the name of Wanda and Harry, Wanda and Harry each received a separate property gift equal to 1/2 the value of the home. The separate property character of the gift may be overcome by the exact wording of the title. If Wanda's mom deeded the townhouse to "Wanda and Harry, as a married couple," "Wanda and Harry, in the entirety," "Wanda and Harry, as community property," or "Wanda and Harry, as community property with the right of survivorship" then the gift would be to the community and not to the individual parties. The townhouse is the separate property of Wanda and Harry who each have a 1/2 interest worth \$150,000 on the date of recording.*

What is the character of the debt and the associated \$100,000 funds incurred during the marriage on the townhouse? *Debts incurred during the marriage are preemptively community property debts. The resulting funds are community property funds. And anything purchased with those funds are treated as if the community made the purchase. This presumption may be overcome by proving the intention of the bank. If a spouse can prove to the court that the bank intended to make the loan based solely on the separate property assets and separate property credit worthiness of a single spouse, then the presumption is rebutted. However, this presumption is seldom overcome because most*

banks do not want to release the obligations of another potential mortgagor or debtor who could pay back the debt should the other party become delinquent. Because the debt is incurred during marriage, the debt is preemptively community property. The fact that the underlying townhouse is a separate property asset belonging to each spouse is not relevant to this analysis. Both the debt and the \$100,000 funds are community property.

Does the debt create a reimbursement right? *When a separate property asset is used to acquire a community property asset, the separate property owner gets a reimbursement right. The right exists until it is clearly and expressly waived by the affected party above that party's signature. Here, the townhouse is separate property of Wanda and separate property of Harry. Each of them gets a reimbursement right for their contribution to the community's \$100,000 cash asset which attached to the townhouse.*

Do payments on the loan create a community property interest in the separate property townhouse? *A reimbursement right (discussed above) is created without changing the character of the underlying property, thus a community property loan leveraged against a separate property asset does not transmute the asset into community property or grant a pro tanto interest to the community. A pro tanto interest (a.k.a. a fractional ownership interest of the community in a separate property asset together with a fractional interest in appreciation of the asset) is created only when the community makes payments on a separate property mortgage which was used to purchase the separate property realty. Under that circumstance, the interest would be defined by the Moore/Marsden formula. Here, the community will receive no interest in the townhouse from the payments on this loan, because the debt is a community property debt leveraged against separate property which created a reimbursement right to the separate property owners. Payments made on this note using community property funds will reduce the amount of the reimbursement right by effectively reimbursing the separate property owners for the borrowed funds. Separate property funds used to pay down the community property debt will incur a new reimbursement right which will be balanced by the reduced reimbursement from the principal reduction of the loan. Thus, when Harry uses the community property money from the community property account (Harry's Account), he repays the reimbursement right and does not change the ownership interest of the townhouse. No, payments using either separate property money or community property money on this loan will not create a pro tanto community property interest in the townhouse.*

Do community property improvements alter the characterization of the townhouse or its appreciated value? *Improvements to property merge into the property. California law gives the contributor to the improvement a reimbursement right for the amount contributed but does not give any ownership of associated appreciation.* Here, Wanda used community property money to improve a separate property asset. The \$20,000 spent from the community property funds must be reimbursed to the community from the separate property benefactors. The reimbursement is likely to be taken from the equity value of the home, but it may be settled separately. Because of the 50/50 split of the property, Wanda and Harry would each owe the community a \$10,000 reimbursement from whatever source they deem most appropriate. After being reimbursed, the community has no additional interest in the house based on these improvements. No, the improvements do not alter the ownership interest in the home.

Does Wanda have a reimbursement right for the money spent on mortgage payments during her exclusive use of the property after separation? *A party may obtain reimbursement for principal reductions on community property debt using separate property funds after separation. Wages earned after separation are separate property once again, regardless the gender of the wage-earner. When that money is used to reduce a community property debt, such as a mortgage principal balance owned by the community, the party earns a reimbursement right. This reimbursement right is waived when the party making the payments has exclusive use and control of the asset. When the party has exclusive use and control of a community property home, the community deserves a fair market value for the rents on the property. This fair market value may be reduced by payments made to the mortgage.* Here, Wanda has exclusive use of the home. If the townhouse were community property, she would owe the community a fair market value, which would be reduced by principal reductions paid-for by her separate property wages. In the analysis above, we determine that absent an intent of the mother to gift the townhouse to the community that the title form of "Wanda and Harry" creates an equal separate property interest in the townhouse. Thus, the rules apply as would be applied to separate property co-owners and not the rules of community property. It is likely that Wanda will owe Harry one-half of a fair market value for the rental, because she has excluded him from his separate property home. However, this debt is incurred outside the community. Similarly, Wanda does not get a reimbursement right in the community debt reduction because she has exclusive use of the home, which is considered a fair reimbursement for her contributions toward the

community debts. Here, the separate character of the home becomes more expensive for Wanda, because if the townhouse were community property, she could reduce her debt to Harry by the reduction in principal on the associated mortgage. No, Wanda does not get a reimbursement right for her mortgage payments.

Who is responsible for the missed payments on the mortgage? *Community creditors may access the community assets or the separate property assets of each community member. Until a court awards a community debt to a single party, the community remains liable for all payments.* Even though Wanda and Harry separated, the court had not yet assigned the community debt to a single party, thus the community remains liable for each mortgage payment. When Wanda missed payments, the community incurred a past-due debt. Even though Wanda is responsible for the missed payments, the Community will be responsible for making the missed payments and any associated late fees. Note, that this does not impact the liability that Wanda has to Harry for fair rental value of his half of the separate property townhouse. The community is responsible for the missed mortgage payments.

How should the \$450,000 be divided by the Court when the property sells? *See above for allocations and characterizations.*

1. The \$450,000 proceeds is entirely the separate property of Wanda and Harry, because they owned the house free and clear prior to the community property mortgage. Each party will be awarded 1/2 of the \$450,000 into a separate property fund from which community property debts may be deducted if the community is unable to pay them. Each party will thus start with a separate property value of \$225,000.
2. The balance on the mortgage was reduced by \$50,000 when Harry paid it down from community property funds. This is a community property debt thus no reimbursement right exists for this expenditure.
3. The community will receive a \$20,000 credit for the reimbursement of improvements. This will reduce the separate property funds of each party to \$215,000 and provide \$20,000 to the community for community expenses.

4. The community is responsible for the \$9,000 in missed payments (6 x \$1,500) (we will assume no late fees for convenience). This will reduce the \$20,000 community balance to \$11,000. Each separate party still retains \$215,000 credit.

5. Wanda does not get reimbursed from the community for her payments made during the time she had exclusive use of the home.

6. Harry will reimburse Harry's Account from his \$215,000 for the \$20,000 he took. This will provide the community an additional cash asset value of \$40,000 and reduce Harry's cash by \$20,000. Harry will now receive \$195,000 from the house. Wanda will receive \$215,000 from the house. The community has \$51,000 (\$11,000 from step 4 plus \$40,000).

7. The community will pay the balance of the community debt (\$50,000) which will leave the community \$1,000 from the sale of the house with remaining \$0 in Harry's Account. The settling of this debt erases the \$100,000 reimbursement right owed to Harry and Wanda for their separate property contributions to the community mortgage. At this point, Harry is receiving \$195,000 from the house, Wanda is receiving \$215,000 from the house, and the community is receiving \$1,000 from the house.

6. Wanda owes Harry 1/2 of the fair market value for the entire time that she had exclusive use of the home. This is his fair share of the fair-market rent due to him as a 1/2 owner of the separate property townhouse. We are unable to adjust the credit balances for this debt, because we do not know how long Wanda had exclusive possession of the house or what fair market value is. For the purpose of demonstrating the math, we shall assume a value of \$20,000 as fair market value, thus Wanda owes Harry his half which is \$10,000. Based on this hypothetical value, Wanda would now be owed \$205,000, Harry would now be owed \$205,000, and the community would be owed \$1,000.

At the end of this analysis, either Wanda or Harry could buy out the interests of the other parties and avoid the sale of the home by paying \$205,500 to the other party. (The \$1,000 paid to the community results in a \$500 refund and a \$500 payment to the other party, thus the \$205,500).

END OF EXAM

3)

Q3

Pursuant § 760, California (CA) is a community property (CP) state. There is a community property presumption, meaning that all property acquired during marriage is CP. This includes the labor of either spouse and labor of either spouse during marriage. There are areas of separate property (SP): 1) property acquired before or after marriage, 2) property acquired during marriage by either spouse through gift, will, or inheritance, 3) property acquired from SP fund, and 4) profits, rents, and issues of SP. The burden is on the spouse opposing SP to defeat the CP presumption. Courts use the source rule to determine the character of the property by tracing the source of the funds used to acquire the property.

H'S WIDGET (WIDGET) COMPANY RIGHTS

SP is property is all property acquired before marriage, or the rents, profits, and issues of that SP. Here, just prior to marriage, H started his widget business. Since this is before the couple's marriage, it will be considered SP. However, there may be a community interest in widget because it increased to \$5,000,000 at the time of their separation. Where a SP business operated by spouses generates profits or increases in value, the must apportion those profits and increases between CP and SP interests due to the spousal efforts. The courts use the *Pereira* and *Van Camp* methods which must be just and equitable.

PEREIRA

This method is often used when the increase in business is primarily due to the spousal efforts and skill. The SP owner is given their initial SP investment at the date of marriage, plus a fair rate of return. When the court determines the rate of return, they will use a reasonable market rate, but if there us no evidence, they will use the judgement rate of 10%. Here, H started widget just prior to marriage with a \$50k investment. During the marriage, H used his tireless efforts to build the business. H did so by reinvesting his already low wages back into widget. Because of his tireless efforts, widget climbed in value to \$5,000,000. Because of these efforts, the court will most likely determine that a reimbursement is in order at $(\$50,000 \times 10\%) \times 2$ years.

VAN CAMP

The *Van Camp* method is often used when the increase in the business is primarily due to extrinsic factors such as the industry or market and nature of the business. The SP owner is given their initial SP investment at the date of marriage, plus reasonable compensation for their efforts less any salary given or community expenses paid from the business. Here, H vastly underpaid himself in order to build the business. The facts state the H's efforts contributed to the success of widget thus, the court is more likely to use the *Pereira* method. If W can p[rove that the increase in the business is due to market conditions, she would be entitled to a bigger apportionment of the community interest. W will definitely want to argue that she also contributed to the increase in the value of widget, however, H already compensated W for her contribution. Thus, a court will most likely use the *Pereira* method.

H'S PERSONAL INJURY SETTLEMENT

A personal injury settlement that results from an injury sustained during marriage is presumptively CP. Legal relevance is placed upon when the injury occurred, and not on when the settlement is awarded. Upon divorce, however, the injury settlement belongs to the injured spouse: it is treated as the injured spouse's SP. The community is, however, entitled to reimbursement for medical expenses paid with CP when SP was available. Here, H was injured by a car during marriage. Since the MEC existed at the time of the accident, the settlement will be CP. AT divorce, payments for a settlement are treated as SP, unless economic hardship to the other spouse, unless there is economic hardship or commingling. Because the insurance policy could not be accessed before the settlement, W and H had to take a loan. There is hardship to H however, the settlement was awarded after separation thus, the MEC was at an end. W can claim that CP funds were used when they took a loan to cover H's medical expenses. For the issue of the \$100k loan, it is CP to the extent that compensation is intended to replace marital earnings and SP if the compensation is intended to replace post-separation earnings. Because the laon was taken to supplement H's earnings because he could not work until further surgeries were completed, the court will most likely consider the loan a CP liability which would be split 50/50.

H'S MEDICAL EXPENSES

Traditionally, non-debtor SP funds cannot be reached, however, an exception on liability for medical bills exists. Each spouse has a duty to support the other spouse and minor children. Each spouse is personally liable for the the other spouse's contracts for necessities. Creditors can reach CP funds and SP funds from either spouse which applies even the MEC has ended. After a divorce, a creditor

cannot reach CP awarded to a spouse unless that spouse incurred the debt or was assigned the debt. Here, since H has incurred tremendous debt while married and cannot work until further surgeries are completed, W owes a duty to support. Thus, the medical expenses are CP.

DISABILITY INSURANCE POLICY

Disability insurance is characterized as CP or SP depending on what the wages they are designed to replace. If the payments are designed to replace marital earnings, the disability pay is CP. If the payments are designed to replace post-divorce earnings, the disability pay is SP. It is immaterial that the right to receive the payments was earned during the course of the marriage. Here, the facts state that no payments were awarded. Given the fact that H could not work and had to cover medical expenses by way of a loan highlights that H needed the money as a replacement to his earnings. Thus, the insurance is CP.

PERSONAL INJURY (PI) SETTLEMENT FUNDS

Generally all funds acquired during marriage is presumptively CP. With regards to PI settlement awards, if the cause of action arose during the MEC, the settlement award is CP unless, the settlement awards is from the other spouse and they are the tortfeasor. Since the PI funds were awarded after the date of separation, the awards is SP. Although the PI funds result from an accident that arose during marriage, upon divorce, the court usually awards the funds exclusively to the injured spouse. In this case, W may argue that even though the funds were paid after divorce, they were initially CP. To rebut this, H will argue that the award should be paid to him since he was the injured party. The courts will most likely rule in favor of H since he was in fact the victim and no tracing issues are apparent. In this case, the court will most likely determine that the PI wards will be CP because the cause of action arose during marriage.

END OF MEC

This MEC ended when the parties intended to not continue marital relations, and take actions consistent with that intent such as W filing for a divorce and H moving out of the townhouse. Here W and H separated in 2019 and divorced after that. We do not know too much on the intent other than what the facts provide which tends to paint a picture of intentional separation. Whether the parties intended to continue marital relations may not matter, the fact that W and H separated in 2019 is sufficient conduct to infer that they intended for MEC to have ended.

END OF EXAM