

First Supplement to Memorandum 83-8

Subject: Study D-312 - Liability of Marital Property for Debts (Division of Debts at Dissolution of Marriage)

Memorandum 83-8 discusses the concept of equitable division of debts between the spouses at dissolution of marriage. The memorandum concludes that although the court should have some discretion in assigning a particular debt to a particular spouse, the net allocation of debts and assets between the spouses should be equal. The memorandum also declines to deal at this point with the problem of what debts are "separate" debts of a spouse and thus not part of the division and what debts are "community" debts and thus chargeable against the community property in the division.

Professor Paul J. Goda writes (Exhibit 1) that he agrees with the concept of a net equal division of assets. However, he goes on to suggest a scheme for distinguishing separate and community debts at division on the basis of community benefit. Professor Bruch also proposes distinguishing separate and community debts for purposes of division at dissolution. Bruch, The Definition and Division of Community Property in California: Towards Parity and Simplicity, 33 Hastings L.J. 769, 857 (1982).

This is clearly a matter the Commission should address. The question is: When? The staff believes it is preferable to deal with this problem in the context of division of assets as a whole. We touch upon the problem in the present recommendation on liability of marital property only because we alter the rule that a creditor may reach former community property after dissolution, and a corresponding adjustment appears necessary to permit the court to take into account the rights of creditors in assigning debts. While specifying rules for assignment of debts might be the next logical step, it is not a simple matter and we've got to cut off collateral issues at some point and proceed to the Legislature. In the staff's opinion, we have reached that point; we can deal with the problem of assigning debts in another context.

One point that Professor Goda raises we do believe the Commission should review at this time. The staff draft in Memorandum 83-8 requires that although the court must take into account the rights of creditors

in assigning debts, the net overall division of property must be equal. This could have the effect of overruling In re Marriage of Eastis, 47 Cal. App.3d 459, 120 Cal. Rptr. 861 (1975). In Eastis the court deviated from the basic equal division requirement and provided that in the "bankrupt family" situation where there are no assets to divide, only obligations, or where the obligations exceed the assets, the court has discretion to order the payment of the excess obligations in a manner that is just and equitable, depending upon the respective earning capacities of the spouses and other relevant factors. "Common sense would indicate that we should look to the respective abilities of the parties to pay these obligations. Thus, if one of the spouses has an earning capacity of \$1,000 per month and the other has an earning capacity of \$500 per month, it would be patently unjust to order the parties to pay the community debts equally." 47 Cal. App.3d at 464.

Although the staff draft could have the effect of overruling Eastis, it is ambiguous on this point. The Comment should state expressly whether Eastis is overruled or preserved. Our community property experts are not in agreement on this matter. Professor Bruch would codify the Eastis rule. 33 Hastings L.J. at 857-58, n.360. Professor Reppy has written to the staff that he is opposed to the Eastis rule. Professor Goda accepts the Eastis rule.

The policy conflict here is between equality and equity. Equality demands that when the spouses part, debts incurred for their common benefit should be shared equally, regardless of financial position. The Eastis court, favoring equity in the bankrupt family situation, thinks that "this is carrying principles of sexual egalitarianism too far. Whatever one may think of the social philosophy underlying the Family Law Act, at this point the need for absolute equality between husband and wife vanishes and certain pragmatic considerations take over." 47 Cal. App.3d at 463. Equity demands that the debts be assigned to the person better able to pay; this would also be advantageous to creditors.

Of course, the person assigned the debts under the Eastis rule may well request that the court reserve jurisdiction over the issue in case the other party becomes capable of sharing the burden of paying the debts in the future. See Tobriner, Who Pays Marital Debts: Allocation of Responsibility Between Spouses, 9 CTLA Forum 88, 89 (1981). It might

also be proper under equitable principles, to allow the person assigned the debts to seek reimbursement at some time in the future if the financial circumstances of the parties change.

The staff has no strong feelings on this issue. Both the equality and the equity positions make sense to us. The equality position is simpler.

The Commission should decide.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

EXHIBIT 1



THE UNIVERSITY OF SANTA CLARA

December 17, 1982

SCHOOL OF LAW

(408) 984-4286

Mr. Nat Sterling
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4000 Middlefield Road, Room D-2
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Dear Nat:

Things seem to be moving for the Community Property study. I hope to be present at your meeting on the evening of Jan. 21 and on Jan. 22 if the agenda holds firm on taking up the Community Property items.

The reason that I write is based on some suggestions that the staff made in Memorandum 83-8, Study D-312--Liability of Marital Property for Debts (Revised Draft of Recommendation). I am writing partially on that draft but also on what apparently will be another study sometime in the future.

On pp. 4 and 5 of Memo 83-8, the staff suggests language amending suggested CC 4800 b5. By that language, it is suggested that the division of property must be equal, even if in dividing the debts, the court take into consideration the earning capacity of the spouses and other factors. The memo goes on on p. 5:

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.

Let me throw some ideas out now and I will probably bother you with them again at the time of that later study. I strongly agree with the suggested change insofar as it emphasizes equal division. What I wonder about is that you seem to be saying that there should be an equal division of the assets and then make allowances for an unequal division of the debts. I can see this for the Marriage of Eastis (47 CalApp 3rd 459, 120 CalR 861) situation in which liabilities exceed assets but I am not enamored of this solution where there are sufficient assets to pay off debts.

I think that the California policy, or what I think the California policy is or should be, is truly equal division of the estate. The strange language in Marriage of Barnert (85 Cal App 3rd 413, 149 CalR 616) seems to bear this out:

...it must be realized that the community obligations were acquired during the marriage and must be divided at the time of dissolution of the marriage, not equally, but in a manner so as to equalize the residual assets.

I think this says what I am trying to say in different language, that California policy is equal division of the estate. There should not be equal division of the assets and then division of the obligations but some sort of synchronization between the two.

This is why I think that the staff's statement in Memo 83-8 quoted above that the problem of distinguishing separate and community debts "is really distinct" is incorrect.

Let me essay some distinctions:

- 1) A separate debt in the strict sense is a debt which has given no actual benefit to the community and for which community property as such is not liable. A pre-marital debt is an example of such a debt. I realize that cases and statutes have made community property liable, and then exempted earnings, but bear with me for a moment.
- 2) A community debt in the strict sense should be one which has given actual benefit to the community and for which community property as such is liable. Again, I realize that the separate property of the debtor spouse is liable and of the non-debtor spouse if they are necessities but I am trying to emphasize the notion of benefit to make a point, that this kind of community debt should relate to the assignment of debts to both spouses.
- 3) A community debt in the broad sense is one which has not given actual benefit to the community but for which community property as such is liable. Such are the debts incurred during marriage under CC 5116, whether for the benefit of the community or not. "The property of the community is liable for the contracts of either spouse..." But this definition is aimed at the rights of the creditor, not at allocation between spouses. In a strange way, Harley v. Whitmore 242 CalApp2d 461, 51 CR 468 bears me out because it denies the applicability of the definition of community debt in the strict sense to the case and to California law. But the law it is talking about is the law of the rights of creditors, not the law relating to allocation between spouses.

Based on these distinctions, I would argue that the fairest way to divide an estate--the "property" at the time of divorce is to allocate:

- 1) true separate debts to the spouse who incurred them.
- 2) strict community debts which have given benefit to the community to both spouses.
- 3) broad community debts only (in the sense that they have not given actual benefit to the community) to the spouse who has enjoyed or is enjoying the benefit.

This distinction is not like your equitable division in the first draft of your tentative recommendation in CC 4800 b5 because it gives criteria for division based on who has enjoyed the debt. Let me give some examples:

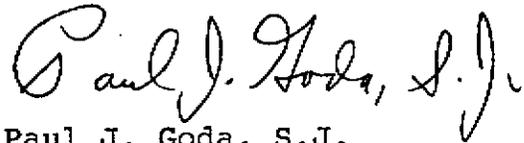
- 1) true separate debts. A pre-marital debt, even though community property might have been liable during marriage, would simply be allocated to the spouse who incurred it. Unpaid alimony would be such a debt. There would be no problems with rights of creditors because their ability to get at the community property was based on a continuing marriage relation only.
- 2) true community debts. Food for both, parties for both, clothing for one which is used during the marriage, these kinds of debts should be allocated evenly to both because both benefited from them during marriage.
- 3) broad community debts only, more specifically debts incurred during marriage which were not for the actual benefit of the community. An example of this was the mortgage debt in Marr. of Barnert 85 CalApp3rd 413, 149 CalR 616 which the trial court gave to the wife but by doing so made her come out way ahead on the division of property. The appellate court said that the debt should simply be allocated to the spouse who took the house. This seems to me to be saying that the spouse who will enjoy the benefit should pay for it.

I must emphasize that I am not advocating Washington's community debt doctrine which applies to rights of creditors and which has crept into our law in ordering of funds responsible for tort debts in CC 5122b. What I am trying to do is to figure out which debts should be divided equally and which debts should go to one spouse alone. I think that this does affect the equal division of property.

Thus, I would suggest the following addition to the staff's suggested amendment of CC 4800 b5:

and that debts which have benefited the community are allocated equally to both parties. Where total assets are exceeded by the total community debts, the court may divide the debts and assets equitably according to the capacity of the parties to pay measured by earning capacity.

Sincerely,



Paul J. Goda, S.J.

PJG:md

APPENDIX:

Let me attach some numbers to examples. Assume the following facts: At the time of divorce, there is a total amount of community property worth \$200,000, SP of H worth \$200,000 and SP of W worth \$100,000. Claims are as stated below:

TOTAL	CLAIMS	CLAIMS ALLOCABLE TO			
		Interest of H		Interest of W	
		H's ½ CP	H's SP	W's ½ CP	W's SP
		100,000	200,000	100,000	100,000
\$500,000 assets					
	2,000 food bill incurred by H	1,000		1,000	
	2,000 clothing bill incurred by H for clothing used dur. marr.	1,000		1,000	
	2,000 clothing bill incurred by H for clothing "5 seconds before parties separate" (1)		2,000		
	900 car repair bill incurred by W			450	
	6,000 debt of H incurred by H in accident not for benefit of comm. (2)		6,000		
	3,000 debt contracted by W prior to marr.				3,000
	50,000 debt in H's business which has no CP assets (incurred dur. marr.) (3)		50,000		
	50,000 debt in W's business which has CP assets able to cover the debt (incurred dur. marr.) (3) (4)	25,000		25,000	

- (1) I use this silly example for my class to try to illustrate a debt which should be allocated to the spouse who has incurred the debt. It is a broad community debt only because there is no benefit to the community but it is a community debt for which community property as such is liable under CC 5116 to protect creditors.
- (2) This simply follows CC 5122b.
- (3) I give the contrasting businesses to try to illustrate a point I have not fully resolved in my own mind. In a business without assets to divide, that business can be left to the spouse who runs the business as can the debt. In a business which has assets to divide, the $\frac{1}{2}$ of the debt can be allocated to the spouse who is not running the business. This would also be a share of the business because when it is paid off, part of the business is owned by that spouse. If the spouse does not want to get saddled with the debt, the other spouse who is running the business can "buy out" by assuming the full debt.

In the case of a business which has no assets and over which the spouse running it has had single management and control, the full debt can be allocated to the spouse running the business on the assumption that there was no benefit to the community even if its income may have supported the spouses.

- (4) I would hope that Prof. Reppy would agree with me. In his article on Debt Collection in 18 SDLR 143 at pp. 175-178, he does enunciate a benefit test for reimbursement.