MARITAL PROPERTY LIABILITIES: DISPELLING THE MYTH OF THE COMMUNITY DEBT (HANDLING THE DEBTS OF THE SURVIVING SPOUSE FOLLOWING THE DEATH OF THE FIRST SPOUSE)

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I. INTRODUCTION

What happens to the debts of a married couple when the first spouse dies? The question sounds simple enough. It is obvious that the debts don't go away. Not all of the debts were the debts of both spouses. There were no community debts. Prior to the first spouse's death, the surviving spouse may or may not have had personal liability for the debts of the deceased spouse, and the deceased spouse may or may not have had any personal liability for the debts of the surviving spouse. The deceased spouse's death does not create any personal liability on any party that did not exist prior to the deceased spouse's death. The surviving spouse is still personally liable for the debts of the surviving spouse. The surviving spouse does not assume the debts of the deceased spouse.

A. Section 37

On the other hand, the deceased spouse's "estate" generally passes to the deceased spouse's heirs and/or devisees subject to the deceased spouse's debts. The decedent's "estate" is liable for the payment of the debts of the decedent. Tex. Prob. Code § 37. If appointed and qualified, the personal representative of the deceased spouse's estate shall recover possession of the decedent's "estate" and hold it in trust to be disposed of in accordance with the law. Tex. Prob Code § 37. "As trustee, the executor is subject to the high fiduciary standards applicable to all trustees." Humane Society v. Austin National Bank, 531 S.W.2d 574,577 (Tex. 1975).

B. The Courts' Explanation

The Texas Supreme Court has explained the legal effect of the transition of ownership and liability by reason of the owner/debtor's death by and through the decedent's "estate." "A suit seeking to establish the decedent's liability on a claim and subject property of the estate to its payment should ordinarily be instituted against the personal representative or, under certain circumstances, against the heirs or beneficiaries." Price v. Estate of Anderson, 522 S.W.2d 690, 691 (Tex. 1975). "Debts against an estate constitute a statutory lien. This lien arises at the moment of death." Janes v. Commerce Federal Savings & Loan Association, 639 S.W.2d 490, 491. "Possession, then, by an heir does not subject him to liability. He holds the property with the incumbrance, but he can not be required to relieve the estate of the burden [sic]." Blinn v. McDonald 50 S.W. 931, 931 (Tex. 1899), Van v. Webb 215 S.W.2d 151, 154 (Tex. 1998).

C. The Deceased Married Debtor

If the decedent was a married at the time of death, the decedent's separate property portion of the "estate" and the decedent's one-half of the community property portion of the "estate" vests in the decedent's heirs/devisees, but subject to debts of the decedent. Tex.

Prob. Code § 37. Section 37 does not mention the *debts* of the surviving spouse.

On the other hand, following the first spouse's death and the appointment and qualification of the personal representative for the deceased spouse's estate, the personal representative, in its fiduciary rule, is authorized to administer, not only the separate property of the deceased spouse, but also any community property which was under the deceased spouse's control during the marriage and the community property which was under the joint control of the spouses during the marriage. The surviving spouse can retain during administration possession and control over any community property which was subject to that spouse's control during the marriage. Tex. Prob. Code § 177.

Section 156 of the Texas Probate Code states that the one-hundred percent (100%) of the community property subject to the sole or joint control during the marriage continues to be subject to the *debts of the deceased spouse*. In addition, the decedent's one-half interest in the community property subject to the sole control of the surviving spouse passes to the deceased spouse's successors charged with the *deceased spouse's debts*. Tex. Prob. Code § 156.

D. Questions

It is important to note that Section 156 does not address the *debts of the surviving spouse* for which the deceased spouse had no personal liability ("herein referred to as the "survivor's debts" which are owing to the survivor's creditors"). It only mentions the *deceased spouse's debts*. Consequently, is the personal representative of the deceased spouse's estate:

- Required to give the Section 295 "notice to holders of a secured claim," if the secured creditor is the survivor's creditor? Does it matter if the property securing the debt is the survivor's separate property or community property that was subject to the survivor's control prior to the decedent's death (thus, not subject to administration pursuant to Section 177)? (Presumably, if the property was any other type of community property (joint controlled or decedent's controlled), the debt would be a joint obligation of both spouses, and the issue is moot since the debt is a debt of the deceased spouse.)
- Authorized to give the Section 294(d) "permissive notice to unsecured creditors" to the survivor's creditors in order to trigger the four month bar rule, preempting the general statute of limitations?
- Authorized to "allow or reject a claim for money" under Section 309 in a court supervised administration, or "approve,

classify, and pay, or reject" a claim for money under Section 146(a) in an independent administration, if the creditor is the survivor's creditor?

• Excused from pleading to a suit brought against an independent personal representative by the survivor's creditor until after six months from the date the independent administration was created pursuant to Section 147?

E. Creditor Questions

Are the survivor's creditors:

- Required, or permitted to present their claims for money, triggering the application of Sections 301-304 and 307-315 in a court supervised administration of the deceased spouse's estate?
- Required, or permitted, to pursue claims which are not claims for money by filing suit against the personal representative of the deceased spouse's estate, thereby triggering the rules for pursuing such a claim in a court supervised administration?
- Required, or permitted, to pursue their claims in an independent administration of the deceased spouse's estate, thereby triggering section 147 and permitting the independent executor to delay pleading to any such suit until six months after the independent administration was created?
- Authorized to elect to have a secured claim allowed and approved under Section 306 as either a "matured secured claim" or a "preferred debt and lien." Does it matter if the property securing the debt is the survivor's separate property or community property that was subject to the survivor's control? (Presumably, if the property was any other type of community property, the debt would be a joint obligation of both spouses, and the issue is moot since the debt would be a debt of the deceased spouse.)

F. Effect on Statue of Limitations

Section 16.062 of the Texas Civil Practice and Remedies provides that the death of a debtor suspends the running of the applicable statute of limitations for 12 months after death or the date a personal representative qualifies, which ever occurs first. Section 299 of the Texas Probate Code provides (subject to Section 294(a)) that the general statute of limitations are tolled on the date a *claim for money*, which is required to be presented, is filed or deposited with the clerk in a court supervised administration, or suit on a claim which is not one for money in a court supervised administration. or any suit is brought against the personal representative in an independent administration.

Are these statutory provisions applicable to the debts of the surviving spouse?

G. Purpose

Accordingly, the purpose of this paper is to try to find answers to these and other questions relating to the debts of a married couple when the first spouse dies.

II. CHARACTERIZATION

The Supreme Court of Texas in *Arnold v. Leonard*, 114 Tex. 535, 273 S.W. 799 (1925) and *Kellett v. Trice*, 95 Tex. 160, 66 S.W. 51 (1902) made it clear to practitioners and the legislature that it is the Texas Constitution which ultimately defines what is separate or community property and not the legislature or the parties involved. Accordingly, in order to properly characterize marital assets in Texas, it is necessary to understand the Texas Constitution.

A. Article XVI, Sec. 15

All property, both real and personal, of a spouse owned or claimed before marriage, and that acquired afterward by gift, devise or descent, shall be the separate property of that spouse; and laws shall be passed more clearly defining the rights of the spouses, in relation to separate and community property; provided that persons about to marry and spouses, without the intention to defraud preexisting creditors, may by written instrument from time to time partition between themselves all or part of their property, then existing or to be acquired, or exchange between themselves the community interest of one spouse or future spouse in any property for the community interest of the other spouse or future spouse in other community property then existing or to be acquired, whereupon the portion or interest set aside to each spouse shall be and constitute a part of the separate property and estate of such spouse or future spouse; spouses may also from time to time, by written instrument, agree between themselves that the income or property from all or part of the separate property then owned or which thereafter might be acquired by only one of them, shall be the separate property of that spouse; and if one spouse makes a gift of property to the other that gift is presumed to include all the income or property which might arise from that gift of property; spouses may agree in writing that all or part of their community property becomes the property of the surviving spouse on the death of a spouse; and spouses may agree in writing that all or part of the separate property owned by either or both of them shall be the spouses' community property.

B. The True Test for Community

It is important to note that the Constitution does not define community property. Arnold v. Leonard, supra, explained the significance of the Texas constitutional approach to characterization: if an asset does not fall within the constitutional definition of separate property, it must be community property — "the rule of implied

exclusion." A logical extension of this rule leads to a more practical definition for the term "community property": that property of the marriage which is not proven to be separate property. See II.G, infra.

The court in *Graham v. Franco*, 488 S.W. 2d 390 (Tex. 1972), resorted to a more historical Spanish/Mexican approach and affirmatively defined community property as "... that property is community which is acquired by the works, efforts, or labor of the spouses..." *See* also *Whittlesey v. Miller*, 572 S.W.2d 665 (Tex. 1978); *Bounds v. Caudle*, 560 S.W.2d 925 (Tex. 1977).

Absent an agreement of the parties and notwithstanding these cases, the author is of the opinion that "the rule of implied exclusion" remains the true test of what is community property. The affirmative test mentioned in *Graham* has been used only in those situations where the implied exclusion rule would have worked an awkward result such as in personal injury recoveries.

C. Traditional Means of Creating Separate Property

Consequently, the first step of characterization is ascertaining the facts and circumstances surrounding the acquisition of an asset -- "the inception of title rule." Creamer v. Briscoe, 109 S.W. 911 (Tex. 1908). The second step is determining whether those facts and circumstances place the asset within the definition of separate property. Prior to the 1980 Amendment to Art. XVI, Sec.15, there were limited means of creating separate property in Texas. Separate property was limited to:

1. PREVIOUSLY EXISTING

Property owned prior to marriage. Tex. Fam. Code Sec. 3.001.

2. GRATUITOUS TRANSFERS

Property acquired during marriage by gift, devise or descent. Tex. Fam. Code Sec. 3.001.

3. TRACEABLE MUTATIONS

Property acquired during marriage which was traceable as a mutation of previously owned separate property. Love v. Robertson, 7 Tex. 6 (1851).

4. MARITAL PARTITIONS

Property resulting from the partition of presently existing community property. Tex. Fam. Code Sec. 4.102.

5. CERTAIN CREDIT ACQUISITIONS

Property acquired on credit during marriage is separate property if the creditor agreed to look only to separate property for repayment. *Broussard v. Tian*, 156 Tex. 371, 295 S.W.2d 405 (1956). See IV, *infra*.

6. CERTAIN PERSONAL INJURY RECOVERIES

Personal injury recoveries (other than for loss of earning capacity). Tex. Fam. Code Sec. 3.001.

D. 1980 Amendment

The 1980 amendment to Art. XVI, Sec. 15 authorized the creation of separate property in new ways:

1. PREMARITAL PARTITIONS

Persons intending to marry can partition and exchange community property not yet acquired. *See* also Tex. Fam. Code Sec. 4.003.

2. SPOUSAL PARTITIONS

Spouses may now partition and exchange not only presently existing community property but also community property not yet in existence into the spouses' separate properties. *See* also Tex. Fam. Code Sec. 4.102.

3. INCOME FROM SEPARATE PROPERTY

Spouses may also agree that income from one spouse's separate property will be that spouse's separate property. *See* also Tex. Fam. Code Sec. 4.103.

4. SPOUSAL DONATIONS

A gift by one spouse to the other spouse will be presumed to include the income generated by the donated property so that both the gift and the future income from the gift are the donee spouse's separate property. *See* also Tex. Fam. Code Sec. 3.005.

E. 1987 Amendment

The 1987 amendment to Art. XVI, Sec. 15 did not authorize a new way to create separate property. It simply allowed spouses to create survivorship rights with their community property.

F. 1999 Amendment

The 1999 amendment to Art. XVI, Sec. 15 permitted spouses to convert by agreement separate property into community property beginning on January 1, 2000.

G. Community Presumption

Notwithstanding the significance of the substantive rules of characterization, the importance of the community presumption cannot be ignored. Generally, all assets of the spouses on hand during the marriage and upon its termination are presumed to be community property, thereby placing the burden of proof on the party (e.g., a spouse, or that spouse's personal representative, or the heirs/devisees of the spouse) asserting separate character to show by "clear and convincing evidence" that a particular asset is, in fact, separate. Tex. Fam. Code Sec. 3.003. A "clear and convincing evidence" standard is somewhere between "preponderance" and "reasonable doubt". Faram v. Gervitz-Faram, 895 S.W.2d 839 (Tex. App.—Ft. Worth 1995, no writ). However, the Texas Supreme Court has held that the requirement of a clear

and convincing evidence standard is another way of stating that a legal conclusion must simply be supported by factually sufficient evidence. *See Meadows v. Green*, 524 S.W.2d 509, 510 (Tex. 1975), (A decision prior to the 1987 amendment to the predecessor to Sec. 3.003 which codified the clear and convincing evidence standard.)

1. MANAGEMENT PRESUMPTION

The fact that an asset is held in one spouse's name only, or is in the sole possession of a particular spouse, is not determinative of its marital character and only raises a presumption that the asset is subject to that spouse's sole management and control while the community presumption dictates it is presumptively community. Tex. Fam. Code Sec. 3.104.

2. FORM OF TITLE

The fact that record title is held in a particular way due to certain circumstances may cause the community presumption to vanish in favor of a rebuttable separate presumption. See Smith v. Strahan, 16 Tex. 314 (1856); Higgins v. Johnson's Heirs, 20 Tex. 389 (1857); Story v. Marshall, 24 Tex. 305 (1859). The other spouse may not be allowed to rebut the presumption if that spouse was a party to the transaction. Lindsay v. Clayman, 151 Tex. 593, 254 S.W.2d 777 (1952).

H. Quasi-Marital Property

According to the Texas Family Code, the separate property of a spouse which was acquired while the spouses were not residing in Texas, but what would have been community had they resided in Texas at the time of acquisition, will be treated in a divorce proceeding as if it were community property. Tex. Fam. Code Sec. 7.002. See Cameron v. Cameron, 641 S.W.2d 210 (Tex. 1982). A 2003 amendment to Sec. 7.002 treats as separate property any community property that was acquired while the couple resided in another state that would have been separate had they resided in Texas at the time of its acquisition. Quasi-community property is still treated as separate if the marriage terminates by reason of a spouse's death. Hanau v. Hanau, 730 S.W.2d 663 (Tex. 1987). Presumably "quasi-separate" property would be treated as community property if the marriage terminates by reason of a spouse's death, if the reasoning of the Hanau case, supra, is followed.

I. Personal Injury Recoveries

Personal injury recoveries for loss of earning capacity during marriage are defined as community property. Tex. Fam. Code Sec. 3.001(3). Notwithstanding this statutory provision, the author is of the opinion that actual "lost earnings" should be deemed community property while "loss of earning capacity" should be considered separate property. Lost earnings are properly characterized as community property since the community estate will be liable for payment of medical

expenses and will suffer as a result of losing one spouse's However, characterizing the community earnings. recovery for lost earning capacity as community property requires a presumption that the husband and wife will remain married indefinitely. In reality, should the spouses divorce following the injury, community recoveries will be divided on a just and right basis; or should the noninjured spouse die, his estate will be entitled to one-half of the entire recovery. Since the primary purpose of a personal injury recovery is to compensate the injured spouse, classifying lost earning capacity as community property and giving the non-injured spouse a one-half interest therein may leave the injured spouse with only a fraction of the amount awarded. The potential for such a situation clearly warrants a distinction between lost earnings and lost earning capacity which characterizes the former as community and the latter as separate.

J. Observations

Today, in order to properly characterize the assets of a marriage in either an estate planning or administration situation, the practitioner will need to be thoroughly familiar with the ever changing rules of characterization and be alert to the possibility that in either a premarital or marital agreement the parties changed the legal result. For example, income from separate property is not always community property.

III. MANAGEMENT OF MARITAL PROPERTY

Unlike characterization, rules relating to the management of marital property are within the rulemaking authority of the legislature. *Arnold v. Leonard*, *supra*. During the marriage, the Texas Family Code prescribes which spouse has management powers over the marital assets.

A. Matrimonial Property Act, 1967

Historically in Texas, the husband managed not only the community property of the marriage but also the separate property of both spouses. A women's rights reform movement began in 1913 with the gradual expansion over the next fifty years of the wife's right to manage her own separate property and personal earnings. One of the early changes was to grant to the wife the right to manage her own personal earnings and the income from her separate property. This reform movement culminated in 1967 when both spouses were granted separate but equal rights in the management of their respective separate properties. The Matrimonial Property Act of 1967 also granted women for the first time the right to manage their special community property and equal rights with their husbands to manage their joint community property. This reform movement also introduced a complementary system of divided liability of community property, which also incorporated two related, but separate concepts: (i) liability of property and (ii) the personal liability of a spouse. These concepts were initially codified as Sections 5.61 and 5.62 of the Texas Family Code enacted in 1969, effective Jan. 1, 2000, and are codified currently as Sections 3.201, 3.202 and 3.203 of the Texas Family Code. See Joseph W. McKnight, "Recodification and Reform of the Law of Husband and Wife" (Texas Bar Journal, Jan. 1970).

B. Texas Family Code

1. SEPARATE PROPERTY

Each spouse has sole management, control and disposition of his or her separate property. Tex. Fam. Code Sec. 3.101.

2. SOLE MANAGEMENT COMMUNITY PROPERTY

Each spouse has sole management, control and disposition of the community property that he or she would own, if single, including personal earnings, revenue from separate property, recoveries for personal injuries and increases and revenues from his or her "special community property." Tex. Fam. Code Sec. 3.102(a).

$\begin{array}{ccc} \textbf{3.} & & \underline{\textbf{JOINT MANAGEMENT COMMUNITY}} \\ & & \underline{\textbf{PROPERTY}} \end{array}$

All other community property is subject to both spouses' joint management, control and disposition – "the joint community property." Tex. Fam. Code Sec. 3.102(b).

C. Special Community Property

The term "special community property" was originally defined by Texas courts as that portion of the community estate which was under the wife's exclusive control and not liable for the husband's debts following the landmark decision of Arnold v. Leonard, supra, where the Texas Supreme Court held that the legislature could not define the rents and revenue from the wife's separate property and her personal earnings as her separate property, but could exempt those assets, her "special community property," from his debts. Moss v. Gibbs, 370 S.W.2d 452 (Tex. 1963). Today, it is common practice to refer to the community assets subject to either spouse's "sole management, control and disposition" under Section 3.102(a) as his or her "special community property." One spouse's special community property is generally not liable during the marriage for the other spouse's contractual debts or any debts of the other spouse that were incurred prior to marriage. See Patel v. Kuciemba, 82 S.W.3d 589 (Tex. Civ. App.—Corpus Christi, 2002 pet. denied) and IV, A.2., infra.

D. Presumptions

Notwithstanding the community presumption of Section 3.003, an asset titled in one spouse's name (or is untitled but is in the sole possession of one spouse) is presumed to be subject to that spouse's sole management and control. Tex. Fam. Code § 3.104. See II, G supra.

Thus, an asset held in either spouse's name is presumed to be that spouse's special community property.

IV. MARITAL PROPERTY LIABILITY

In Arnold v. Leonard, supra, the Texas Supreme Court held that ". . . the Legislature may rightfully place such portions of the community as it deems best under the wife's separate control, and . . . it may likewise exempt the same from payment of the husband's debts, without the exemption being open to successful constitutional attack by either the husband or his creditors." Prior to the Matrimonial Property Act of 1967, Texas law was relatively simple. The husband was generally personally liable for all community debts, and the wife was not. See Leatherwood v. Arnold, 66 Tex. 414, 1 S.W. 173(1886). Further, all community property other than the wife's special community property was liable for the husband's debts. Arnold v. Leonard, supra. The rules changed when the legislature passed the Matrimonial Property Act of 1967 and codified its concepts into the Texas Family Code.

A. Texas Family Code

The legislature's basic rules of marital property liability are found in Sec. 3.202 and Sec. 3.203 of the Texas Family Code.

1. SEPARATE PROPERTY EXEMPTION

A spouse's separate property is not subject to the liabilities of the other spouse. Tex. Fam. Code Sec. 3.202(a).

2. SPECIAL COMMUNITY EXEMPTION

A spouse's special community property is not subject to any of the liabilities incurred by the other spouse prior to the marriage or any nontortious liabilities of the other spouse incurred during the marriage. Tex. Fam. Code Sec. 3.202(b).

3. OTHER RULES OF LAW

The above exemptions exist unless both spouses are personally liable under "other rules of law." Tex. Fam. Code Sec. 3.202(a) and (b).

4. CREDITOR'S RIGHTS

A spouse's separate property and special community property and the spouses' joint community property are subject to any liabilities of that spouse incurred before or during the marriage. In addition, the special community estates of both spouses are subject to the tortious liabilities of either spouse incurred during marriage. Tex. Fam. Code Sec. 3.202 (c) and (d).

5. ORDER OF EXECUTION

A judge may determine, as deemed just and equitable, the order in which particular separate or community property is subject to execution and sale to satisfy a judgment. In determining the order, the court is

to consider the facts and circumstances surrounding the transaction or occurrence on which the debt is based. Tex. Fam. Code Sec. 3.203.

B. Other Factors

1. JOINT OBLIGATIONS

Of course, both spouses may sign a contract or commit a tort which would make them jointly and severally liable and thereby subjecting all of the marital assets to liability.

2. VICARIOUS LIABILITY

The law has defined situations where any person can be held personally liable for certain acts of another. These situations include the following relationships: respondeat superior, principal/agency, partnership, joint venture, etc. These special relationships can exist between husband and wife and can impose vicarious liability on an otherwise innocent spouse. *See Lawrence v. Hardy*, 583 S.W.2d 795 (Tex. App.—San Antonio 1979, writ ref'd n.r.e.). However, the marriage relationship alone is not sufficient to generate vicarious liability. Tex. Fam. Code Sec. 3.201.

3. **DUTY TO SUPPORT**

Each spouse has a duty to support the other spouse and a duty to support a child generally for so long as the child is a minor and thereafter until the child graduates from high school. Tex. Fam. Code Secs. 2.501 and 154.001. Accordingly, all marital assets are liable for such "necessaries." Prior to 2007 legislation, unless otherwise agreed in writing or ordered by a court, a parent's child support obligation ended when the parent died. SB 617 (2007) amended the family code to provide that court ordered child support obligations survive the obligor's death. Tex. Fam. Code Sec. 154.006. New sections of the family code now also provide that the obligor's child support obligations will be accelerated upon the obligor's death and a liquidated amount will be determined using discount analysis and other means. Tex. Fam. Code Sec. 154.015. An amendment to the probate code makes the liquidated amount a class 4 claim. Tex. Prob. Code Sec. 322. The court can also require that the child support obligation be secured by the purchase of a life insurance policy. Tex. Fam. Code Sec. 154.016.

4. TAX LIABILITY

Because each spouse only owns one-half of the community income, notwithstanding the rules of management, if the spouses file separate income tax returns, each spouse is to report one-half of his/her community income and one-half of the other spouse's community income, thereby becoming personally liable for the tax liability of one-half of the total community income. However, it appears as if the IRS can attach (i) one-half of the special community property of the other spouse and (ii) all of the deficient spouse's special

community property to satisfy the tax liability of the deficient spouse. *See Medaris v. U.S.*, 884 F.2d 832 (5th Cir. 1989).

5. EXEMPT PROPERTY

Of course, the family homestead and certain items of personal property are generally exempt from most debts, notwithstanding the Family Code rules. Tex. Prop. Code Secs. 41.001 and 42.001. Such exemptions may extend beyond the death of the owner if the owner is survived by a constituent family member. Sec. 42.0021 of the Texas Property Code also exempts certain retirement benefits.

6. EFFECT OF DEATH

The death of a spouse can change the statutory framework of marital property liability. For example, the Texas Probate Code appears to allow the decedent's one-half interest in the other spouse's special community property to be reached in order to satisfy a nontortious debt incurred during marriage by the decedent. *See* VII, *infra*.

C. Legislative Mandate

The legislature prescribes a logical liability system which depends on a multiple step process to determine which assets are liable for which debts:

- First, whose debt is it? It is either the debt of the husband, the debt of the wife or both spouses' debt.
- Second, when was the debt incurred? It was incurred either prior to or during the marriage.
- Third, what type of debt is it? It is either tortious in nature or contractual.
- Fourth, are there any other substantive, nonmarital rules of law which would make one spouse personally liable for the debts of the other spouse?

After answering these four questions, one can look to Sec. 3.202 and Sec. 3.203 for the proper result.

D. Summary

A spouse's separate property and special community property, as well as the joint community property, are liable for that spouse's debts. If the liability is a tort debt incurred during the marriage, the other spouse's special community property is also liable for the debt (the other spouse's separate property is exempt).

If the debt is not a tort debt incurred during the marriage, the other spouse's separate property and special community property are exempt from the debt unless the other spouse is personally liable under other rules of law. In which event, the other spouse's property (i.e., that spouse's special community and separate) is liable as well. See IV, B *supra*.

E. "Community Debt"

Despite the plain import of the statutory plan enacted by the legislature, some courts continue to create confusion for the practitioner by referring to the term "community debt" or "community obligation" as if the community were an entity separate and apart from the spouses, which "entity" could own property and incur debts. Similarly, some courts still rely on opinions expressed in cases decided prior to the Matrimonial Property Act of 1967 and the subsequent enactment of the Texas Family Code.

F. A Mockery

A recent court of appeals decision stated: "Unless it is shown that [a] creditor agreed to look solely to the separate estate of the contracting spouse for satisfaction, § 3.201 has no effect on the long standing presumption that debts contracted during the marriage are presumed to be on the credit of the community and, thus, are joint community obligations." *Mock v. Mock*, 216 S.W.3d 370, 374 (Tex. App.—Eastland 2006, pet. denied).

1. SECTION 3.201

Again, a Texas court ignores the legislative mandate of the Texas Family Code. Section 3.201 limits the personal liability of one spouse for the debts of the other spouse to only situations where (i) the debtor spouse incurs the debt acting as the agent of the other spouse or (ii) the debtor spouse incurs a debt for "necessaries." Further, the marital relationship, in and to itself, does not create a principal/agency relationship among the spouses. See IV, B supra.

2. THE SO CALLED PRESUMPTION

There is no presumption that debts contracted during the marriage are on the credit of the community and joint community obligations. The long standing presumption is that property acquired on credit is community property unless the creditor agreed to look only to the acquiring spouse's separate property for satisfaction. See II, C, 5, supra. The Mock court's statement conflicts directly with Section 3.201 and is inconsistent with today's legislative marital liability mandate. (Recall, the Texas Supreme Court has held that marital liability is defined by the legislature. See Arnold v. Leonard 114 Tex. 535, 273 S.W.799 (1925)) Mock's inaccurate statement is misleading dicta.

3. THE REAL ISSUE

The actual issue before the court in *Mock* was whether a divorce court could order a wife to pay her husband's credit card debts out of the joint community property and the husband's special community property (the divorce court had already properly awarded the joint community and husband's special community property to the wife). The court of appeals held that the trial court did not err in so ordering the wife to pay the husband's debts under the circumstances.

4. ERRONEOUS STATEMENTS

Nevertheless, the court included the misleading quote referring to the "long standing presumption", citing as its authority, *Cockerham v. Cockerham*, 527 S.W.2d 162 (Tex. 1975) (Recall, *Arnold v. Leonard* was ignored in the majority opinion of the *Cockerham* decision). *Mock* also cites *Kimsey v. Kimsey*, 965 S.W.2d 690, 702 (Tex. App.—El Paso 1998, pet. denied) which cites *Cockerham* as its authority, as well as other court of appeals decisions which cite *Cockerham*. *Cockerham* is the source of all of this confusing and misleading rhetoric.

G. COCKERHAM v. COCKERHAM

In Cockerham v. Cockerham, 527 S.W.2d 162 (Tex. 1975), the Texas Supreme Court stated that ". . . debts contracted during marriage are presumed to be on the credit of the community and thus are joint community obligations, unless it is shown the creditor agreed to look solely to the separate estate of the contracting party for satisfaction." The Cockerham court erroneously cited as its authority for the concept of "community debt" the cases of Broussard v. Tian, 156 Tex. 371, 295 S.W.2d 405 (1956) and Gleich v. Bongio, 128 Tex. 606, 99 S.W.2d 881 (1937).

1. BROUSSARD & GLEICH

A review of *Broussard* and *Gleich* reveals that both cases were characterization cases, not liability cases, where the courts explain that property acquired during the marriage on credit is community absent a showing that the creditor agreed to look only to the decedent's separate property for satisfaction. The Texas Supreme Court had earlier explained why property acquired on credit is generally community property. It is because the status of property is determined at the time the loan was secured, and such a transaction is not an exchange of separate property and the property acquired was not acquired by gift, device or descent. Thus, it is community property under the "rule of implied exclusion." *Heidenheimer v. McKeen* 63 Tex. 229 (1885).

Gleich simply confirms that property acquired on credit is presumptively community property. The court does make references to "community obligations" and "credit of the community," but the decision is a 1951 case, prior to the 1967 change in law. Broussard explains the exception to the general rule that property acquired on credit is community property unless there is proof of an agreement to make the note a "separate property obligation." In other words, since a spouse's separate property cannot be the "obligor," the creditor has agreed to look only to the borrower's separate property for satisfaction (i.e., the creditor agrees not to look to any community property for satisfaction).

While the *Broussard* court again makes reference to a "community obligation," meaning absent the lender's agreement so described, community property is liable for the debt, it is important to again note that this is a pre-1967 case. At the time *Broussard* and *Gleich* were

decided, the husband managed all of the community, save and except the wife's "special community property" as described in Moss v. Gibbs, supra. That special community of the wife was exempt from the husband's debts. See Arnold v. Leonard, supra. Prior to 1967, the wife was not personally liable for the husband's debts and her special community property was exempt from her husband's debts. References to "community debt" or "community obligation" were to the debts of the husband that could be satisfied out of all of the community property except the wife's special community property. "Texas statutes do not define the term"community debt." Brooks v. Brooks, 515 S.W.2d 730, 733 (Tex. App.—Eastland 1974, writ ref'd n.r.e.) Thus, the terms "community debt" and "community obligation" must be interpreted within a particular statute or opinion within the parameters set by the time and circumstances of the issue presented.

2. COCKERHAM DISSENT

Three of Texas' most respected jurists, Thomas M. Reavely, Joe R. Greenhill and Ruel C. Walker, understood the legislative mandate, as evidenced in Justice Reavley's well-reasoned dissent in *Cockerham* where he wrote:

I had supposed that the Texas Family Code as enacted and amended by the 61st, 62nd and 63rd Legislatures places a creditor who deals with one spouse in a position where, in the event of subsequent unpaid debts and liabilities, he might not be able to reach that community property which is not held solely in the name of the spouse with whom he deals. Section 5.24 protects the creditor to the extent that he can assume the spouse has sole management of property in that spouse's name. However, the other community property may well be under the sole management of the other spouse by the terms of § 5.22, which so specifies for property that the other spouse "would have owned if single" and which also gives effect to agreements between the spouses, whether or not the agreement is known to the creditor. If the other spouse has sole management, under § 5.61 that property is beyond the creditor's reach. If that state of the law was disturbing to creditors, they can now relax while spouses with separate estates do the worrying. The Court today seems to hold that a wife (or husband) who assents to the husband (or wife) spending community funds in a venture thereby subjects her (or his) total estate to any liability that the husband's (or wife's) venture may precipitate.

3. TOTALITY OF THE CIRCUMSTANCES

Cockerham also seemed to extend the facts and circumstances under which one spouse could be held liable for the debts of the other spouse by announcing, in effect, a "totality of the circumstances" test and thereby placed at risk all of the assets of either spouse whenever either spouse incurred a liability during the marriage, a result obviously not contemplated by the legislature in enacting the predecessor to Sec. 3.202.

4. JUDICIAL/LEGISLATIVE INCONSISTENCIES

References to "community debts" imply that the "community" is liable for the debt (i.e. all community property can be used to satisfy the debt); it also suggests that both spouses are personally liable because they are the community. This result is inconsistent with legislative mandate and the statutory plan of the Texas Family Code. For example, a wife's special community property is not liable for the husband's contractual debts unless she is liable under another substantive rule of law. Marriage itself does not create joint and several liability. See IV, B., supra.

5. ANTI-COCKERHAM LEGISLATION

1987 legislation should be interpreted as putting an end to the Cockerham rules. Texas Family Code Sec. 3.201 provides that one spouse will be personally liable for the acts of the other spouse only if the other spouse acts as the agent of the otherwise innocent spouse or the other spouse incurs a debt for "necessaries." Tex. Fam. Code Sec. 3.201. In addition, the predecessor to Sec. 3.202 was amended to refer specifically to the predecessor to Sec. 3.201 in determining when one spouse's special community property would be liable for the debts of the other spouse. Hopefully, this legislation will place the determination of marital property liability where it belongs - the statutory plan of Sec. 3.202. Some court of appeals' opinions indicate that the courts understand the legislative mandate. See Patel v. Kuciemba, 82 S.W.3d 589 (Tex. App.—Corpus Christi, 2002), "The fact that Manu and Ilaben were married As a matter of law, this cannot be evidence of apparent authority because a spouse does not act as agent for the other spouse solely because of the marriage relationship." See also Montemayor v. Ortiz, 208 S.W.3d 627 (Tex. App.—Corpus Christi 2006, no writ) and Carr v. Houston Business Forms, Inc., 794 S.W.2d 849 (Tex. App.—Houston [14th Dist.] 1990, no writ).

H. Prof. McKnight's Explanation

Over twenty-five years ago, Professor McKnight in his annual survey of Texas Family Law, 37 S.W.L.J. 65 at 77 (1983) said: The phrase "community debt" has long been useful in characterizing borrowed money or property that a spouse buys on credit. If the lender or seller does not specifically look to the borrower's or buyer's separate property for payment, it is clear that a community debt has been incurred, and thus that the money borrowed or property bought is community property. But to take the phrase out of this context, as well as to say that the designation of such a debt as "community" makes both spouses liable for it (when only one of them has contracted it), is clearly contrary to the express terms of section 5.61. [Tex. Fam. Code Ann.] (the predecessor to Section 3.201). Under Texas law as amended and recodified in 1969, a community debt means nothing more than that some community property is liable for its satisfaction. A community debt may at the same time be a separate debt, unless the creditor agrees to seek satisfaction from community property only. Hence when the creditor has not agreed to limit recovery from one marital estate or the other, he may proceed against either for satisfaction. Confining the term community debt to its traditional characterization context would remove a great source of confusion and discourage the tendency of some courts to find separate debts where a section 5.61 community debt was clearly intended by the parties concerned.

<u>Note:</u> Of course, Professor McKnight was instrumental in the drafting and enactment of the marital property laws that ushered in the Texas Family Code. It is time that all Texas courts get on board with the legislative mandate.

I. Bottom Line

Reliance on Cockerham, Broussand and Gleich, as authority for the so called "long standing presumption that debts contracted during the marriage are joint community obligations," is reliance on a single statement in Cockerham taken out of context from Broussard and Gleich. Those two cases were decided by the Texas Supreme Court when Texas law, in a "by gone era," held that a husband is personally liable for all community debts, that a wife is not personally liable for community debts, and further a surviving wife is not liable for community debts. See Leatherwood v. Arnold, 66 Tex. 414, 1. S.W. 173 (1886). Of course, Leatherwood was decided prior to Arnold v. Leonard, which led to the new concept of "wife's special community property." But, the point is that reliance on any pre-1967 case is not necessarily good authority to resolve an issue today involving marital property management and liability.

V. MARITAL PROPERTY IN PROBATE

When a married resident of Texas dies, the marriage terminates and community property ceases to exist. Death works a legal partition of the <u>community probate assets</u>; the deceased spouse's undivided one-half interest passes to his heirs and/or devisees, and the surviving spouse retains an undivided one-half interest therein. There is not a "just and right" division of the community as in the divorce court; neither is the concept of quasi-community recognized. *See Hanau v. Hanau*, 730 S.W.2d 663 (Tex. 1987).

A. Administration of Community Property

In addition to collecting the assets of the estate, paying the decedent's debts and distributing the remaining assets to the decedent's heirs and/or devisees, the administration of a married decedent's estate includes the actual partition of the community probate property. While death may work a legal partition of the community probate assets, it is often necessary to open an administration to effectively handle the claims of creditors and/or divide the community probate property among the surviving spouse and the decedent's heirs and/or devisees.

Absent the opening of a formal administration, the surviving spouse administers the community and can discharge the "community obligations." *See* Tex. Prob. Code Sec. 160. See VI, *infra*.

<u>Note</u>: If the deceased spouse died intestate and the surviving spouse is the sole heir, there is no need for any type of formal administration. Tex. Prob. Code Sec. 155.

B. Probate v. Non-Probate

The estate of a decedent must initially be divided into two separate and distinct categories. Certain assets fall within the <u>probate</u> class and others are placed in the non-probate classification.

1. NON-PROBATE

An asset is non-probate if during the decedent's lifetime, the decedent entered into an inter vivos transaction, as opposed to a testamentary transaction, that controls the disposition of the asset at death. Many nonprobate dispositions are contractual arrangements with third parties or the intended beneficiaries, and the terms of the contracts control the dispositions. Common examples of these types of contractual arrangements include three of the multiple-party bank accounts discussed in Chapter XI of the Texas Probate Code, most life insurance policies and certain employee benefits. Tex. Prob. Code Sec. 450. In other non-probate dispositions, the ownership of a future interest in the property is transferred to the intended beneficiary during the owner's lifetime, and the future interest becomes possessory upon the death of the owner. Revocable trusts and springing executory interests are examples of these types of non-probate dispositions. Of course, an inter vivos gift of the ownership and possession of an asset prior to the owner's death can be considered a non-probate disposition.

2. PROBATE

Probate assets are those assets which are not controlled by an inter vivos arrangement and pass at the owner's death through probate administration and on to the owner's heirs or devisees. A married individual's probate estate consists of the decedent's separate probate assets and his or her one-half of the community assets which are not subject to an inter vivos or non-probate arrangement. The surviving spouse retains, not inherits, his or her one-half interest in the community probate assets.

C. Intestate Death

1. COMMUNITY PROBATE PROPERTY

If a spouse dies intestate, the surviving spouse continues to own (not inherits) an undivided one-half interest in the community probate assets. If there are not any descendants of the deceased spouse surviving, or all surviving descendants are also descendants of the surviving spouse, the decedent's one-half interest passes

to the surviving spouse, who would then own the entire community probate estate. If there are any descendants surviving who are not descendants of the surviving spouse, the decedent's one-half interest in the community probate assets passes to the decedent's descendants per capita with right of representation. Tex. Prob. Code Secs. 43, 45. Prior to September 1, 1993, the surviving spouse inherited the deceased spouse's one-half of the community only if no descendants of the deceased spouse were then surviving. Tex. Prob. Code Sec. 45. The rules relating to "representation" were modified to be effective September 1, 1991. Tex. Prob Code Sec. 43.

2. SEPARATE PROBATE PROPERTY

If a spouse dies intestate, the decedent's separate probate assets are divided in the following manner: (i) one-third of the personal property passes to the surviving spouse and two-thirds thereof to the decedent's descendants and (ii) the surviving spouse receives a life estate in one-third of the separate real property and the descendants of the decedent receive the balance of the separate real property. If there are no descendants, the surviving spouse receives all of the personal property and one-half of the real property. The other one-half of the real property passes in accordance with the rules of intestate succession. Tex. Prob. Code Sec. 38.

D. Testate Death

Every person who is or has been married has received a broad grant of authority from the legislature to dispose of his or her probate property. There is no forced heirship in Texas. Tex. Prob. Code Secs. 57 and 58. This broad grant of testamentary authority is, however, effectively limited to the testator's separate probate property and his or her one-half interest in the community probate property. *Avery v. Johnson*, 108 Tex. 294, 192 S.W. 542 (1917). Not even the divorce court can enjoin a spouse from exercising the spouse's testamentary power. *See* Tex. Prob. Code Sec. 69A.

E. Texas "Widow's" Election

It is fundamental that the deceased spouse has testamentary power over only one-half of the community probate assets, whether the community assets are held in the husband's name, the wife's name, or both of their names. An attempt to dispose of both halves of the community is ineffective unless the attempt triggers the application of "equitable election." In Texas, this doctrine has been termed the "widow's election" whether the survivor is a widow or widower.

1. EQUITABLE ELECTION

Whenever any devisee is entitled to a benefit under a will and asked to suffer a detriment under the will, the devisee cannot accept the benefit without suffering the detriment. The choice is left to the devisee who can elect to accept under the will or elect against the will. The most common example of an election is when the testator

attempts to dispose of property which the testator does not own while at the same time devising other property to the actual owner. *See Wright v. Wright*, 154 Tex. 138, 274 S.W.2d 670 (1955). *Dunn v. Vinyard*, 251 S.W. 1043 (Tex. Com. App. 1923, opinion adopted).

2. COMMUNITY PROPERTY ELECTION

It is common for one spouse to attempt to leave a community asset to a third party while leaving the surviving spouse another asset. Such a disposition would put the surviving spouse to an election. The surviving spouse is also put to an election when the decedent gives the surviving spouse a life estate in the entire community estate while expecting the survivor to allow her or his one-half of the community to pass under the decedent's will. *United States v. Past*, 347 F.2d 7 (9th Cir. 1965); *Vardell's Est. v. Comm.*, 307 F.2d 688 (5th Cir. 1962). Compare with the "illusory" inter vivos transfer concept.

3. THE TEXAS RULE

In Wright v. Wright, supra, the Texas Supreme Court explained the Texas rule. First, the will must dispose of property owned by the surviving spouse while at the same time granting some benefits to the surviving spouse. Second, the surviving spouse must elect to allow all or part of his or her property to pass as provided in the will before accepting the benefits conferred. Third, the will must clearly put the survivor to an election.

4. <u>PROCEDURE</u>

The surviving spouse may be put to either an express or an implied election. In other words, the language of the will may specifically and expressly set forth the intent to require an election. Calvert v. Ft. Worth Nat. Bank, 348 S.W.2d 19 (Tex. Civ. App.—Austin, 1961), affirmed 163 Tex. 405, 356 S.W.2d 918 (Tex. 1962). In other situations, the election is implied from the language of the will. The question of whether the survivor is put to an election is one of law for the court. Wright, supra. The question of whether the survivor has made an election is one of fact. Generally, two factors are involved. First, the survivor must have been aware of the choice. Second, the survivor must intend to so elect; however, the totality of the circumstances are considered in making this determination. Dunn v. Vinyard, supra. Mere acceptance of benefits may be deemed an election to take under the will. See Dougherty, "Election", Texas Estate Administration Secs. 8.1, 8.2.

5. TAX CONSEQUENCES

The decision to elect or not can have significant transfer and income tax consequences which are beyond the scope of this article. For a discussion of these matters and an in depth study of the Texas widow's election, see Kinnebrew and Morgan, "Community Property Division at Death," 39 <u>Baylor Law Review</u> 1037, 1072-1079 (1987).

6. SUPER ELECTION

Traditionally, the doctrine of election has required the electing spouse's benefit and detriment to be found in the same disposition (e.g., the deceased spouse's will or revocable trust). Perhaps it is time to consider the "super election" in view of the prevalent use of probate and nonprobate dispositions as part of a comprehensive estate plan. For example, a husband designates his wife as beneficiary of a \$1 million life insurance policy, but purports to specifically devise in his will both halves of a certain \$100,000 community asset to his kids by a prior marriage, without naming his wife as a beneficiary in the will. Should she be able to accept the \$1 million and also assert her rights to one-half of the community asset specifically devised to the kids? Or, if she accepts a significant benefit in the comprehensive plan, shouldn't she be deemed to have accepted the detriment in another part of the plan?

F. Protection for Surviving Spouse

Despite the very broad general grant of testamentary power given a married testator and the limited rights of inheritance given the surviving spouse when the decedent dies intestate, there exists certain constitutional and statutory provisions which protect the surviving spouse, whether the decedent died testate or intestate.

1. HOMESTEAD

The Texas Constitution still exempts the homestead from the claims of some of the decedent's creditors. Tex. Const. Art. XVI, Sec. 50. In addition, notwithstanding the provisions of the decedent's will or the rules of intestate succession, the surviving spouse is given an exclusive right of occupancy of the homestead so long as he or she elects to occupy it as his or her home. Tex. Const. Art. XVI, Sec. 52. This right of occupancy exists whether the home is separate property of the deceased spouse or the couple's community property. In the event there is not a family home, the probate court is required to set aside an allowance in lieu of a homestead. Tex. Prob. Code Sec. 273.

2. EXEMPT PERSONAL PROPERTY

Certain items of tangible personal property are exempt from creditors of the decedent if the decedent is survived by a spouse. Tex. Prob. Code Secs. 271 and 281. These items are described in the Texas Property Code and generally include the household furnishings, personal effects and automobiles in an amount that does not exceed \$60,000. Tex. Prop. Code Sec. 42.002. In addition, during administration, the surviving spouse can retain possession of these items and will receive ownership of these items if the decedent's estate proves to be insolvent; otherwise the decedent's interest in these items passes to his or her heirs and/or devisees when the administration terminates. Tex. Prob. Code Sec. 278. There is also an allowance in lieu of exempt personal property. Tex. Prob. Code Sec. 273.

3. FAMILY ALLOWANCE

In addition to the allowances in lieu of homestead and exempt personal property, an allowance for one year's maintenance of the surviving spouse and minor children may be established by the probate court. Tex. Prob. Code Secs. 286 and 287. The allowance is paid out of the decedent's property subject to administration. *Ward v. Braun*, 417 S.W.2d 888 (Tex. Civ. App.—Corpus Christi, 1967, no writ). The amount is determined in the court's discretion and is not to be allowed if the surviving spouse has a sufficient separate estate. Tex. Prob. Code Sec. 288; *Noble v. Noble*, 636 S.W.2d 551 (Tex. App.—San Antonio 1982, no writ).

VI. ADMINISTRATION OF COMMUNITY PROPERTY

The purposes of a decedent's estate administration are to collect the assets of the estate, to pay the decedent's debts and to distribute the remaining assets to the decedent's heirs and/or devisees. In addition, the administration of a married decedent's estate includes the actual partition of the community probate property. As discussed previously, death works a legal partition of the community probate assets, but it is often necessary to open an administration to effectively set aside the homestead, exempt property and family allowance, handle the claims of creditors and/or divide the community probate property among the surviving spouse and the decedent's heirs and/or devisees.

A. Types of Administration

1. FORMAL AND INFORMAL ADMINISTRATION

Whether the decedent died testate or intestate, it is possible in Texas for the decedent's surviving spouse and distributees to informally administer the decedent's estate. In other words, the assets can be collected, the debts paid and the balance properly distributed without a court appointed personal representative. It may be necessary to admit the decedent's will to probate as muniment of title, or to have a judicial determination of heirship and order of no administration entered by the probate court, in order to establish the distributees' title. Tex. Prob. Code Sec. 89 and Tex. Prob. Code Secs. 48-56. Other situations will require the appointment of a personal representative to formally administer the estate. The personal representative can either be (i) an administrator or executor or (ii) an independent administrator or independent executor. In any event, it is the personal representative's function to accomplish the purposes of estate administration.

2. NECESSITY OF ADMINISTRATION

In order to open a formal administration, the need for an administration must be established to the satisfaction of the probate court. A necessity is deemed to exist if two or more debts against the estate exist, or it is desired that the probate court partition the estate among the distributees. These two statutory provisions are not exclusive. Tex. Prob. Code Sec. 178. The decedent's designation of an executor in his or her will is sufficient cause for the opening of a formal administration.

3. PRIORITIES

If there is a need for formal administration, the persons named as executors in the will are given priority in the selection process of the personal representative. If the named executors are not able to qualify, the surviving spouse, then others, are given priority. If the decedent dies intestate, letters of administration are first granted to the surviving spouse, then others. Tex. Prob. Code Sec. 77.

4. <u>DEPENDENT AND INDEPENDENT</u> ADMINISTRATIONS

The personal representative appointed by the court will be designated either (i) the independent administrator or independent executor or (ii) the executor or administrator. An independent administration is created by will or pursuant to certain specified procedures and allows the independent personal representative to administer the estate free of routine supervision by the probate court. Tex. Prob. Code Secs. 145-154A. If the court fails to grant an independent administration, the personal representative's actions are supervised on a routine basis, and the personal representative must seek the court's authority prior to entering into many transactions. Sec. 145(r) permits an independent executor named in the will who refuses to so act or resigns to qualify as a dependent personal representative.

5. ACCOUNTABILITY

During a dependent administration, the personal representative must file (i) an inventory and list of claims, (ii) annual accountings and (iii) final accountings. These documents must be approved by the probate court. An independent personal representative must file and have approved his inventory and list of claims but has no other formal accounting requirements; however, the representative is accountable to the distributees as is any fiduciary.

6. THE INVENTORY

While there is disagreement among the commentators, it is this author's opinion that the inventory and list of claims should list the assets of the estate which are subject to administration by the personal representative, identifying which assets were community. Since both halves of the certain community probate assets are subject to administration, the inventory and list of claims should account for both halves of the community probate assets, as well as the decedent's separate probate assets. Cain v. Church, 131 S.W.2d 400 (Tex. Civ. App. 1939, no writ). It may be appropriate to identify the decedent's one-half interest in the survivor's special community as a claim. The decedent's nonprobate assets

and the surviving spouse's separate property are not subject to administration and do not belong on the inventory. Tex. Prob. Code Sec. 250. See Ikard and Golden, Administration of Community Property, 1996 Adv. Est. Planning and Probate Course (State Bar of Texas).

B. Distribution of Powers Among Personal Representative And Surviving Spouse

During formal administration, the personal representative is entitled to possession of not only the deceased spouse's separate property but also the couple's joint community property and the decedent's special community property. The surviving spouse may retain possession of the survivor's special community property during administration or waive this right and allow the personal representative to administer the entire community probate estate. Tex. Prob. Code Sec. 177.

The authority of the personal representative over the survivor's one-half of the community should be limited to what is necessary to satisfy the debts of the deceased spouse properly payable out of such community assets even if the decedent's will grants to the representative more extensive powers over the decedent's separate assets and one-half interest in the community. However, if there is a will and the surviving spouse is a beneficiary of the will, the surviving spouse who accepts any benefits under the will may have elected to allow the executor to exercise more extensive powers over his or her share of the community assets during administration.

This division of authority dovetails with the contractual management and liability rules of the Texas Family Code and facilitates the personal representative's ability to step into the decedent's shoes and satisfy his or her debts. Tex. Fam. Code Secs. 3.102 and 3.202. Of course, both the personal representative and surviving spouse should eventually account for both halves of the community in order to settle the estate. If the community assets in possession of the personal representative and available to satisfy the deceased spouse's creditors are insufficient for that purpose, Tex. Prob. Code Sec. 156 indicates that the deceased spouse's one-half interest in the surviving spouse's special community property can be reached to satisfy the deceased spouse's creditors.

2. $\frac{\text{AUTHORITY OF SURVIVING SPOUSE} - \text{NO}}{\text{PERSONAL REPRESENTATIVE}}$

When there is no personal representative for the estate of the deceased spouse, Sec. 160(a) enables the surviving spouse to sue in order to recover community property, to sell or otherwise dispose of community property to pay debts payable out of the community estate, and to collect claims owing to the community estate. The survivor may be sued by a third party in a matter relating to the community estate. That section also grants to the

surviving spouse the authority needed under the circumstances to exercise such other powers as are necessary to preserve the community estate, to discharge obligations payable out of community property and to generally "wind up community affairs."

The survivor is entitled to a "reasonable commission" for administering the community and can incur reasonable expenses in the management of the estate. Like any other fiduciary, the surviving spouse is accountable to the deceased spouse's heirs and/or devisees who are entitled to their share of the remaining community assets after the debts properly payable out of the community assets have been paid. See Tex. Prob. Code Secs. 156 & 168 and Grebe v. First State Bank, 150 S.W. 2d 64 (Tex. 1941).

Note: In 2007, the legislature repealed the provisions of the Probate Code relating to the creation, administration and closing of an administration by a "qualified community administrator." Repealed Sec. 169 directed the community administrator to pay debts within the time, and according to the classification, and in the order prescribed for the payment of debts as in other administrations. Section 160(a) simply directs the surviving spouse to "preserve the community property, discharge community obligations and wind up community affairs."

3. <u>AUTHORITY OF THE SURVIVING SPOUSE – PERSONAL REPRESENTATIVE</u>

When a personal representative is administering the estate of the deceased spouse, including the surviving spouse's one-half of the decedent's special community and the couple's joint community, the surviving spouse's fiduciary authority over the survivor's special community property enables the survivor to exercise all the powers granted to the surviving spouse where there is no administration pending. Tex. Prob. Code Sec. 177. This statutory language suggests that the survivor can deduct from the special community being administered "necessary and reasonable expenses" and a "reasonable commission." The survivor shall keep a distinct account of "all community debts" allowed or paid. See Tex. Prob. Code Sec. 156. See VII, C infra.

C. Allocation of Liabilities After Death

1. PROBATE ASSETS

As pointed out previously, the Texas Probate Code's division of authority tracks the contractual management and liability rules of the Texas Family Code and facilitates the personal representative's ability to step into the decedent's shoes and satisfy primarily the deceased spouse's contractual debts, but it does not resolve all the issues related to which assets are liable for which debts.

2. NON-PROBATE ASSETS

In the past, practitioners could follow a general "rule of thumb": probate assets pass subject to the decedent's debts whereas non-probate assets pass to their designated beneficiaries, free of the decedent's debts. Today, there is a growing body of statutory rules and common law which negates the application of this old "rule of thumb."

3. GENERAL POWER THEORY

Even if the Uniform Fraudulent Transfer Act is not violated, the Texas definition of a general power of appointment would seem broad enough to capture most non-probate dispositions, including joint tenancies and revocable trusts, within its coverage and, thereby, subject the property in question to the liabilities of the donee of the power, either during the donee's lifetime or at death, unless there is a specific statutory exemption.

4. ABATEMENT

Despite the growing need for a comprehensive statute which would complement Sec. 450(b) of the Texas Probate Code and define the rights of creditors in and to the probate and non-probate assets of a deceased debtor, the legislature has only codified the order in which property in the probate estate would be liable for debts and expenses properly chargeable to the probate estate. Sec. 322B of the Texas Probate Code does not apply to death taxes.

5. <u>ABATEMENT AMONG COMMUNITY AND SEPARATE ASSETS</u>

Sec. 322B also failed to give direction to the personal representative who has both non-exempt separate and community assets in its possession and control in order to satisfy the decedent's debts. The potential conflict of interest is obvious; the expenditure of separate funds to satisfy the debt will inure to the benefit of the surviving spouse while using community funds would accrue to the benefit of the decedent's estate. Presumably Sec. 3.203 of the Texas Family Code would be relevant, and the facts and circumstances surrounding the source of the debt should be considered. For example, is it a purchase money indebtedness? Is it tortious or contractual in nature? The author is not aware of any definitive cases on point that offer the personal representative any clear guidance. Accordingly, it appears that the personal representative should pay certain claims out of the decedent's separate property or the decedent's one-half of community assets. These claims would include funeral expenses, separate property's purchase money indebtedness, and tort claims against the decreased spouse. Other debts, like credit cards, utilities, and community property purchase money indebtedness should be paid out of the community funds being administered by the personal representative. For further discussion and the author's other ideas, see VII, VIII, IX and X, infra.

D. Closing the Estate

Upon the death of the first spouse and while record legal title still reflects that some community assets are held in the decedent's name, some are held in the survivor's name and others are held in both names, the surviving spouse and the heirs and/or devisees of the deceased spouse are, in effect, tenants in common as to each and every community probate asset, unless the surviving spouse is the sole distributee of some or all of the deceased spouse's one-half interest in such assets.

Assuming that the decedent's one-half community interest has been left to someone other than the surviving spouse, the respective ownership interests of the survivor and the decedent's distributees are subject to the possessory rights of either a court appointed personal representative or the surviving spouse for administration purposes. When administration is completed, the survivor and the distributees are entitled to their respective one-half interests in each and every community probate asset. But, see VIII, *infra*.

E. Non Pro Rata Division

Accordingly, can the survivor and the personal representative (or the decedent's distributees) agree to make a non pro rata division of the community estate so that the surviving spouse receives 100% of some of the assets and the distributees receive 100% of other community assets? The answer is an obvious yes. The authority of an executor to enter into such a transaction should depend on the powers granted to the executor in the decedent's will. Of course, even if the will purports to enable the executor to make a non pro rata division of the community, the surviving spouse's agreement is still required. However, the surviving spouse may have already agreed by accepting benefits under the will through either an express or equitable election. See XI, E, infra. The real issue is whether any such agreement will be considered a taxable exchange, subjecting the parties to capital gain exposure to the extent the assets have appreciated in value since the decedent's date of death, a topic beyond the scope of this paper.

VII. EFFECT OF SPOUSE'S DEATH ON DEBTS

Borrowing a description in a different area of Texas law by the Fifth Circuit trying to explain Texas law, both "inarticulateness and over expression," as well as the failure to appreciate how the law changed in 1967 due to legislative mandates, continue to create confusion for the practitioner advising a personal representative on how debts should be paid following the death of the first spouse to die. For example, courts continue to ignore clear legislative mandate with general statements of law that might have been more accurate before the changes in the 1960s that introduced the concept of divided management and liability of marital property.

A. The Red Herring

For example, in *Estate of Herring*, 983 S.W.2d 61, 63 (Tex. App—Corpus Christi, 1998 no pet.), the court states: "The community assets of an estate, although they may vest in the surviving spouse and heirs upon the decedent's death, and held subject to the payment of community debts and subject to the right of a duly appointed and qualified personal representative to have possession and control during administration.... More over, while under the jurisdiction of the probate court, all community property, including the half interest of the surviving spouse, is subject to administration and sale by the probate court as part of the estate of the deceased spouse." As its authority, for this explanation of Texas law, the court cites no case later than 1971.

The court also makes a parenthetical reference to Section 177 (an executor is authorized to administer all community property subject to the sole or joint management of the deceased spouse) but the court ignores that reference in its inaccurate general statements of the law.

Of course, its general statements were accurate within the facts of the case, since the only property at issue was, in fact, joint community property prior to the first spouse's death.

B. 1971 Amendment to Sec. 156

Following the enactment of the original Texas Family Code in the late 1960s, with it revolutionary system of divided marital management and liability rules, the legislature in 1971 attempted to clarify what debts would be payable out of the community property after the death of a spouse by amending Sec. 156 of the Texas Probate Code. Prior to 1971, Section 156 simply stated: "Community property, except as is exempt from forced sale, shall be charged with all valid and enforceable debts existing at the time of the dissolution of marriage by death."

1. <u>1971 LANGUAGE</u>

"The community property subject to the sole or joint management, control, and disposition of a spouse during marriage continues to be subject to the liabilities of that spouse upon death. In addition, the interest that the deceased spouse owned in any other nonexempt community property passes to his or her heirs or devisees charged with the debts which were enforceable against such deceased spouse prior to his or her death."

2. THE CONTROVERSY

A key issue before the legislature in 1971 was whether the exemption from the husband's contractual debts that the wife's special community property enjoyed should survive the husband's death. The legislature adopted Professor M. K. Woodward's recommendation: The exemption would continue with respect to the wife's one-half of her special community property, but the husband's one-half would be subject to the claims of his

creditors. See Remy, "The Effect of the 1971 amendments to the Probate Code on Control of Community Property After the Death of a Spouse and for Payment of Community Debts," 34 Tex. B.J. 685 (1971).

3. LACK OF GUIDANCE

Unfortunately, the legislature in 1971 (as well as in subsequent sessions) has not provided clear statutory guidance for other related issues. For example, during marriage, the entire community estate is generally liable for any tortions debt of either spouse incurred during marriage. Does all of the community property remain liable for the tort debts of either spouse after the first spouse dies? If the spouse who committed the tort dies, it is clear that the 100% of the deceased spouse's special community and joint community property, as well as the decedent's one-half interest in the surviving spouse's special community property, remain liable. But, Section 156 is silent as to liability of the surviving spouse's one-half of the survivor's special community property following the deceased tortfeasor's death.

4. TORT CLAIMS

In an analysis of the 1971 amendment to Section 156, one leading authority has concluded: "Hence, all of the community that was liable for the debts of the deceased spouse during marriage [including tort debts] will continue to be liable for the same debts after death." Woodward, Smith & Beyer, Texas Practice Series -- Probate and Decident's Estates, § 542 (Thomson Reuters/West, 2008 ed). However, it should be noted that Section 156 literally says only the decedent's special community, the joint community and the decedent's one-half of the survivor's special community are liable for the decedent's debts. It does not list the survivor's one-half of the survivor's special community as being liable, suggesting it is exempt after the tortfeasor's death. See IX, D, infra.

5. SURVIVING SPOUSE'S DEBTS

Section 156 also does not mention the debts of the surviving spouse. So, what procedure does the surviving spouse's creditor follow, if the deceased spouse is not personally liable for the debt? Is the personal representative obligated to pay such a debt? See X, *infra*.

C. Community Debt - The Misnomer

Section 156 of the Texas Probate Code was enacted in 1955, effective Jan. 1,1956. It has been amended twice, in 1971 and 2007, but it is submitted that neither amendment adequately addressed the concept of divided liability described above.

1. ANNOTATIONS

Further, every decision listed in the annotations under Section 156 was decided prior to 1967. It is submitted that any pre-1967 case is questionable authority when applied to a post-1967 situation. In other words, the

reference to "community debts" in Section 156's second sentence is, in the author's opinion, a misnomer under current law, and Section 156 should be interpreted in light of the 1967 changes to Texas marital property law.

2. SECTIONS 160 and 168

Sections 160 and 168 are the only other sections of the Texas Probate Code that make references to "community debts" or "community obligations."

- a. If no one has qualified as the personal representative of the deceased spouse's estate, the surviving spouse "as the surviving partner of the marital partnership" has the power to sue and be sued for the recovery of community property, to sell and otherwise dispose of community property for the purpose of "paying community debts," as well as such other powers as are necessary to "discharge community obligations, and wind up community affairs." Tex. Prob. Code § 168
- b. "The surviving spouse shall keep an account of "all community debts and expenses" paid. Upon final partition, the surviving spouse shall deliver to the heirs or devisees of the deceased spouse their interest in the deceased spouse's estate after deducting the proportion of the "community debts." Tex. Prob. Code § 168. If the deceased spouse died intestate and the decedent's interest in the community property passes to the surviving spouse, no administration of the community property is necessary. Tex. Prob. Code § 155
- c. Sections 160 and 168 were enacted in 1955, to be effective Jan. 1, 1956, and they have been amended since the late 1960s, but it is submitted that their amendments did not adequately address the concept of divided liabilities referred to above. Again, it is submitted that any reference to "community debts" or "community obligations" is a misnomer under current law and those sections should be interpreted in light of the 1967 changes to Texas marital property law. Every relevant decision listed in the annotations under Sections 160 and 168 was decided prior to 1967 or the facts in issue occurred prior to 1967.

3. PROPER TERMINOLOGY

The term "community debt" suggests that both spouses are personally liable on the debt and/or that all community property can be reached to satisfy the debt. However, neither statement may be accurate under the circumstances. Focus under current law should be on the "debts of a spouse," not "community debts." In other words, is the debt the husband's debt, the wife's debt, or the debt of both the husband and wife? See IV, supra.

If the term *community debt* has a post-1967 meaning, it should be limited to those debts of both the husband and wife, (i.e. the liability is joint and several) and all of the community is available to satisfy the debt under Section 3.202, but such a definition would still not necessarily lead to an accurate interpretation of Sections, 37, 156, 160 or 168.

D. 1971 Amendments to Sec. 177

Prior to its 1971 amendment, the relevant parts of Section 177 provided: "...such executor or administrator, as the case may be, is authorized to administer, not only the separate property of the deceased spouse, but also the community property which was by law under the management of the deceased spouse during the continuance of the marriage; and the surviving spouse, as surviving partner of the marital partnership, is entitled to retain possession and control of all community property which was legally under the management of the surviving spouse during the continuance of the marriage...."

Incorporating the concepts of the then newly enacted Texas Family Code, the 1971 version stated: "...such executor is authorized to administer, not only the separate property of deceased spouse, but also the community property which was by law under the management of the deceased spouse during the continuance of the marriage and all of the community property that was by law under the joint control of the spouses during the continuance of the marriage. The surviving spouse, as surviving partner of the marital partnership, is entitled to retain possession and control of all community property which was legally under the sole management of the surviving spouse during the continuance of the marriage...."

Note: Section 177 permits the surviving spouse to waive his or her right to manage the survivor's special community property, thereby permitting the personal representative to manage the entire community during administration. Does this waiver change the rules concerning liability? No statutory answer is given. It is the author's opinion that it does not.

E. Listen to the Supreme Court

In *Arnold v. Leonard*, the Texas Supreme Court approved the authority of the legislature to define the management and liability rules related to marital property. The legislature has responded with Sections 3.101, 3.102 and 3.103 of the Texas Family Code and Sections 156 and 177 of the Texas Probate Code. The basic legislative mandate is straight forward - -

- When the first spouse dies, the couple's joint community property, the deceased spouse's special community property and the deceased spouse's separate property are the marital assets subject to administration and are available to satisfy the deceased spouse's debts.
- While the surviving spouse may allow the personal representative to administer the survivor's special community property, the decedent's separate property, the couple's joint community property and the decedent's special community property are the primary assets subject to the deceased spouse's debts. In addition, the decedent's interest in the

survivor's special community is subject to the decedent's debts.

F. Testator Direction

Notwithstanding the relevant provisions of the Texas Family Code and Texas Probate Code, the deceased spouse's will may include specific instructions on how debts are to be paid. For example, a provision in the will that directs that "all of the testator's debts are to be paid out of the residuary estate" could be interpreted to mean that any debt for which the testator had personal liability is to be paid out of the testator's separate property or one-half of the community property passing as part of the residuary estate. Absent such a provision, some debts are to be paid out of both the testator's and the surviving spouse's halves of the community. The provision, therefore, benefits the surviving spouse to the detriment of the residuary beneficiaries.

A specific provision in a will could be interpreted as benefitting the residuary beneficiaries to the detriment of the surviving spouse, thereby putting the surviving spouse to an election to suffer the detriment as the price to pay for any benefits under the testator's will. See V, E supra.

Note: Sections VIII, IX and X, infra assume that there is not a specific provision in the deceased spouse's will that would affect the default rules of marital liability by reason of a spouse's death.

G. Compare Divorce

While the divorce court can impose on one spouse or the other the responsibility for satisfying a particular debt insofar as the relative rights of the divorcing couple are concerned, such allocation of responsibility does not insulate the "non-responsible" spouse from the debts for which such spouse was personally liable insofar as the creditor is concerned. Further, the assets which could be used to satisfy a creditor's claim prior to divorce can still be reached by that creditor after divorce. The net effect is to leave the "non-responsible" spouse with a claim for indemnification against the responsible spouse. See Stewart Title Company v. Huddleston, 598 S.W.2d 321 (Tex. App.—San Antonio 1980), aff'd, 608 S.W.2d 611 (Tex. 1980) (per curium) and Anderson v. Royce, 624 S.W.2d 621 (Tex. App.—Houston [14th Dist.] 1981, writ ref'd n.r.e.).

VIII. EQUITABLE ADJUSTMENT/ REIMBURSEMENT

Sections 156 of the Texas Probate Code and 3.202 of the Texas Family Code purport to define which assets of the marriage are liable for which debts. Section 3.203 of the Texas Family Code gives a court discretion based on equitable principles to determine which marital assets are to be actually used to satisfy a particular debt. There is not a corresponding provision in the Texas Probate Code, which has as its focus satisfying the decedent's creditors during administration of the decedent's estate.

A. Lack of Statutory Guidance

Noticeably absent from the Texas Probate Code is any significant attention to the relative rights of the deceased spouse's successors in interest and the surviving spouse during the administration of the decedent's estate. What is needed is a marital property "abatement" statute, something similar to Section 322B of the Texas Probate Code, the Abatement of Bequests. Since there is not such a statute, the equitable principles explained in Section 3.203 of the Texas Family Code in satisfying the deceased spouse's debts should be followed. See IV, A(5), supra.

1. EQUITABLE ADJUSTMENT

For example, certain debts should be paid out of the decedent's separate property, if available, and if not and if community property is used to satisfy those debts, an "equitable adjustment" should be made in the partition and distribution of the remaining community property upon the closing of the estate so that the surviving spouse does not pay one-half of a debt that should have been paid out of the decedent's separate property.

2. EQUITABLE REIMBURSEMENT

Other situations may call for "equitable reimbursement" of the community estate out of the decedent's separate estate or "equitable reimbursement" of the separate estate out of the community estate, in order to achieve a fair and equitable partition and distribution of the separate and community assets being administered by the personal representation of the estate.

3. AN EQUITABLE RESULT

For example, certain debts should be paid with community funds, and if the decedent's separate property is used to satisfy the debt, an "equitable adjustment" should be made in the partition of any remaining community assets at the close of the estate so that the decedent's successors are not paying the part of a debt that should be paid by the surviving spouse. If an "equitable adjustment" does not reach a fair and equitable result, the surviving spouse should "reimburse" the estate for one-half of the debt that should have been paid out of community property.

B. Historical Support

While the term "equitable adjustment" may be a new term within this context, "equitable reimbursement" has been used for 150 years in Texas as a means to recompense one marital estate, when funds from that marital estate were utilized to benefit another martial estate. Historically, equitable reimbursement arose during the marriage when one spouse expended community funds to benefit that spouse's separate property, or expended separate funds to benefit community property. See XI, infra.

It is not too much of a stretch to extend the concept of "equitable reimbursement" and to add the concept of "equitable adjustment" to estate administrations where a personal representative, in its fiduciary capacity and within its duty of impartiality, needs to satisfy creditors, and at the same time, balance the relative rights of the surviving spouse and the deceased spouse's heirs and/or devisees. Early Texas cases support this idea. In Williams v. Davis 133 S.W.2d 275 (Tex. Civ. App. Ft. Worth—1939 no writ), the court noted that a husband, after his wife's death, could reimburse himself, if he used his separate property to pay a community debt. Another held a surviving spouse may pay community debts with separate property and reimburse himself by an appropriation of community property. See also Sanger Bros. v. Moody Heirs, 60 Tex. 96 (1883). This power is legalized when the surviving spouse is a "qualified community administrator" (a concept repealed in 2007). Davis v. McCartney, 64 Tex. 584 (1885). If it is legal in the latter, it must have been equitable in the former. See Leatherwood v. Arnold, 66 Tex. 414, 1 S.W. 173 (1886).

C. Tax Elections

The personal representative is required by law satisfy to the deceased spouse's debts, but the decision of how to pay a particular debt can benefit one of the parties of interest at the expense of another (just like a tax election made by an executor may benefit one beneficiary at the expense of another in that context). Noel Ice has asked whether the executer can make, or is required to make, an "equitable adjustment" to even out the effects of tax elections. His research indicated this is a developing area of law in other jurisdictions and has yet to be clearly recognized by Texas courts. See Noel Ice, Post Mortem Elections and Equitable Adjustments: A Brief Checklist (1997), http://www.trustsandestates.net/Nutshell/ PostMortem chklst/postmor.htm. Mickey Davis reported in 2007 that prior to the adoption of the Uniform Principal and Income Act, Texas statutes had no provision for equitable adjustment, although it had been part of the

D. Partition of Co-Tenancies

Texas courts have historically applied the concept of "equitable contribution" when partitioning property owned by co-tenants. See *Roberts v. Roberts*, 36 Tex. 255, 150 S.W.2d 236 (Tex.) And 86 CJS Tenancy in Common § 21 (2009).

common law in other jurisdictions for some time. Davis,

"Ten Things Estate Planners Need to Know About

Income Tax Matters," San Antonio Estate Planning

Council's Docket Call in Probate (Feb. 16, 2007).

E. Conclusion

It is submitted that the only way a fair partition and distribution of the community can occur after the death of the first spouse is to follow the mandate of Section 3.203 and utilize the concepts of "equitable adjustment" and "equitable reimbursement."

IX. DECEASED SPOUSE'S DEBTS

The possible debts of the deceased spouse outstanding at the time of death include: (i) the decedent's unsecured contractual debts for which the surviving spouse has no personal liability ("the decedent's unsecured debts"), (ii) the decedent's contractual debts secured by the decedent's separate property for which the surviving spouse has no personal liability ("the decedent's debts secured by separate property"), (iii) the decedent's contractual debts secured by community property for which the surviving spouse has no personal liability ("the decedent's debts secured by community property"), (iv) the decedent's tort debts for which the surviving spouse has no personal liability ("the decedent's tort debts"), and (v) the contractual or tort, secured or unsecured, debts for which both spouses have personal liability ("joint debts").

The family code's marital liability rules and probate code's procedures appear to provide a relatively straight forward system of addressing the presentation and payment of these debts. If the debt is secured by the decedent's separate property or the decedent's special community property or the couple's joint community property (assets subject to administration pursuant to Section 177), the personal representative must give the Section 295 notice, and the creditor can elect to treat the claim as a matured, secured claim or a preferred debt and lien claim. But, as explained in VIII, supra, the application of equitable principles may be needed to reach a fair partition of the community assets during administration, whether the claim is secured or unsecured, contract or tortious.

A. Unsecured Debts

1. PRE-MARITAL DEBT

If an unsecured was incurred prior to the marriage of the decedent and the decedent's spouse, regardless of the type of debt, the creditor should be able to pursue the debt in due course of administration, and legislative mandate suggests that the personal representative should pay the debt out of the decedent's separate property, if sufficient to satisfy the debt, and if not, out of the community assets in its control, normally the decedent's special community property and then the joint community property.

While the decedent's separate property, the decedent's special community property and their joint community assets are reachable by the creditor under Section 156 and Sec. 3.202 of the Texas Family Code. Sec. 3.203 of the Texas Family Code suggests that a just and equitable order of payment is to be utilized. If the personal representative needs to use community assets to satisfy the debt, equity suggests that only the decedent's one-half (i) of the decedent's special community or (ii) of the joint community should be utilized, although all of the decedent's special community and joint community are, in fact, liable and can be used, if needed to satisfy the debt.

If any of the surviving spouse's one-half of the community is used to pay the debt, wouldn't equitable adjustment or reimbursement be appropriate?

The rationale: Why should the surviving spouse pay for part of a debt that accrued prior to marriage?

2. DEBT DURING MARRIAGE

If the unsecured debt was incurred during the marriage, the creditor can pursue the debt in due course of administration, and legislative mandate suggests that the personal representative should assume that the debt is to be paid out of the community assets under its control, not just the decedent's one-half interest therein. Presumably, the debt was incurred for the "benefit of the community" (such as a utility bill or credit card balances for living expenses). If the community property available to the personal representative is not sufficient to satisfy the debt, the personal representative should then resort to the decedent's separate property. While the decedent's separate property and special community property, as well as the joint community property, are liable for the debt under Section 156 and Section 3.202, the equitable principles of Section 3.203 suggest such an equitable order of abatement is appropriate; and the personal representative should seek "equitable reimbursement" from the surviving spouse for one-half of the amount if separate property is used to pay the debt. Alternatively, an equitable adjustment may be appropriate in the partition and distribution of the surviving spouse's special community property.

The rationale: Why should the decedent's successors pay all of the debt when one-half of the payment accrued to the survivor's benefit?

3. "NOT FOR THE COMMUNITY"

If the unsecured debt was not incurred for the "benefit of the community," the equitable principles of Section 3.203 would suggest that the personal representative should satisfy the debt out of the decedent's separate property prior to using any community property and, if necessary, then the decedent's one-half of the community should be used. Examples of such a debt include an unsecured loan to benefit the decedent's separate property or a debt incurred on behalf of the decedent's child by a prior marriage.

If the decedent's separate property and the decedent's one-half of the community are not sufficient to satisfy the debt, the remaining community assets under the control of the personal representative would be used to satisfy the debt. If so, shouldn't the personal representative either (i) make an "equitable adjustment" in the subsequent partition of any remaining community assets between the surviving spouse and the decedent's successors in interest, or (ii) reimburse the survivor out of the decedent's separate property for the survivor's one-half of the survivor's community property so used?

The rationale: Why should the surviving spouse pay for such a debt of the deceased spouse?

B. Debts Secured by Separate Property

Whether incurred prior to or during the marriage, the secured creditor can pursue the claim in due course of administration and can also elect to treat the claim as a "matured, secured claim" under Section 306, thereby requiring the personal representative to satisfy the debt during administration, notwithstanding the terms of the note and the security instrument.

1. USE OF SEPARATE FUNDS

Whether the debt is treated as a "matured, secured claim" or a "preferred debt and lien," any payments on the debt should presumptively be paid out of the decedent's separate property, although the community property under the control of the personal representative is reachable by the creditor, assuming the decedent was personally liable on the debt. Examples of this type of debt would include purchase money indebtedness and a loan incurred for improvements to the separate property.

2. USE OF COMMUNITY FUNDS

If community funds are used to make any such payments, shouldn't an "equitable adjustment" be made in the division of the remaining community assets (including the surviving spouse's special community)? Alternatively, the personal representative should reimburse the surviving spouse out of the decedent's separate property for the surviving spouse's one-half of any community property used to benefit the decedent's separate property.

The rationale: Why should the surviving spouse pay part of such a debt of the deceased spouse?

3. COMMUNITY BENEFIT

If the debt was incurred during the marriage for the "benefit the community," the equitable principles of Section 3.203 would suggest that the debt should be paid with community funds so that the decedent's separate property passes to the decedent's successors, free of the debt. On the other hand, the decedent had voluntarily encumbered the separate property for the "benefit of the community." Would this factor negate the need for "equitable adjustment" or "equitable reimbursement," if separate funds are used to satisfy the debt?

C. Debts Secured by Community Property

The creditor with a debt secured by joint community property or the decedent's special property community can pursue the claim in due course of administration and can also elect to treat the claim as a "matured, secured claim" under Section 306, thereby requiring the personal representative to satisfy the debt during administration, notwithstanding the terms of the note and the security instrument.

1. COMMUNITY BENEFIT

Whether the debt is treated as a "matured, secured claim" or a "preferred debt and lien", any payments on the

debt should presumptively be paid out of the community property under the personal representative's control, although the decedent's separate property is reachable by the creditor, assuming the decedent was personally liable on the debt. Typically, this type of debt is either a debt incurred to make an improvement to a community asset or to acquire a community asset. Obviously, the debt was incurred for the "benefit the community." If separate funds are used to satisfy the debt, shouldn't an "equitable adjustment" be made to the remaining community assets (including the surviving spouse's special community property), or the personal representative should seek "equitable reimbursement" from the surviving spouse for one-half of the payments.

The rationale: Why should the decedent's successors pay all of the debt when one-half of the payment accrued to the survivor's benefit?

2. NO BENEFIT FOR THE COMMUNITY

However, if the debt was incurred for a reason that was not for the "benefit the community," the equitable principles of Section 3.203 would suggest that the debt should be paid out of the decedent's separate property or one-half of the community property. If not, the personal representative should make an equitable adjustment of the remaining community assets (including the surviving spouse's special community) or reimburse the surviving spouse out of the decedent's separate property for the survivor's one-half of the community so used.

The rationale: Why should the surviving spouse pay for such a debt of the deceased spouse?

D. Tort Debts

The Texas Family Code mandates that all of the community is liable for the tort debts of either spouse during the marriage Tex. Fam. Code Sec. 3.201. Section 3.203's equitable principles suggest, however, that the tortfeasor's separate property should be used first to satisfy the tort. After the tortfeasor's death, Section 156 states that the decedent's separate property, the tortfeasor's special community property and the couple's joint community property remains liable for the tortfeasor's debts. In addition, Section 156 says the tortfeasor's one-half interest in the survivor's special community property passes the heirs and/or devisees, subject to the debt.

1. SURVIVOR'S ONE-HALF

Does 156 exempt from the decedent's tort debt the survivor's one-half interest in the survivor's special community property? A literal reading of Section 156 seems to say: "yes" even though immediately prior to the tortfeasor's death, all of the community, the decedent's special, their joint and the survivor's special, were liable for the decedent's torts.

2. THE SOLUTION?

In any event, the creditor can pursue its claim in due course of administration, and the personal representative should pay the debt out of the decedent's separate property, and if it is not sufficient, perhaps out of the decedent's one-half of the community under its control, and if that is not sufficient, then out of the survivor's one-half of the community under its control. If the creditor is still not satisfied in full, the creditor may pursue the decedent's one-half interest in the survivor's special community per Section 156 and perhaps the survivor's one-half interest, as well, if the literal interpretation of Section 156 is not followed. See IV, *supra*.

3. EQUITABLE PRINCIPLES

If community property is used to satisfy the tort debt of the deceased spouse, Section 3.203 suggests that an equitable adjustment should be made in the partition and distribution of any remaining community property or that the surviving spouse should be reimbursed for the survivor's one-half of the community used to pay the debt.

The rationale: Why should the surviving spouse pay for any part of such a debt?

E. Joint Debts

Whether tort or contract, incurred prior to or during marriage, this type of creditor can pursue the debt against either the personal representative of the estate in due course of administration or the surviving spouse, or both. If pursued against the personal representative, such a debt should generally be paid out of the community property under the control of the personal representative. If the community is insufficient and the debt is paid out of the decedent's separate property, the personal representative should then seek "equitable reimbursement" from the surviving spouse. If the surviving spouse pays the debt out of the survivor's separate property, Section 3.203 suggests that an equitable adjustment should be made in the ultimate partition of the survivor's special community or the survivor should be able to seek "equitable reimbursement" out of the decedent's separate property or one-half of the community property under the control of the personal representative.

The rationale: Shouldn't both spouses bear proportionate responsibility? However, the exact nature of the debt should be considered.

F. Joint Debt Secured by Survivor's Property

If the joint debt was secured by the decedent's separate property, or the decedent's special community property or the couple's joint community property, the personal representative should give the Section 295 notice and the creditor can elect to treat the claim as a matured secured claim or a preferred debt and lien pursuant to Section 306. However, if the debt is secured by the survivor's special community or separate property (assets not subject to administration under Section 177), questions are raised. Must the personal representative

give the Section 295 notice? Can the creditor make the Section 306 election? See X, A(3), *infra*.

X. SURVIVING SPOUSE'S DEBTS

Unfortunately, the Texas Probate Code does not give any statutory guidance on how the debts of the surviving spouse are to be handled following the death of the first spouse. As explained in IV, *supra*, it is a mistake to treat a debt of the deceased spouse or the surviving spouse as a "community debt." A debt is the debt of the wife, the husband or the debt of both spouses. Absent a statutory mandate, it may be necessary to adapt basic marital property and probate concepts, and perhaps introduce some new ones, equitable adjustment and reimbursement in order to reach the proper result.

A. Joint Debts

As explained in IX, E, *supra*, if both spouses had personal liability for a debt during the marriage, the creditor can pursue the claim against the personal representative of the estate of the deceased spouse in due course of administration or against the surviving spouse. These types of debts include a debt for which the spouses had joint and several liability, whether in a contract or a tort situation, a debt incurred by the surviving spouse for "necessaries" for which the decedent also had personal liability, a debt incurred by the surviving spouse while acting as the agent of the deceased spouse, or a debt of the surviving spouse which was guaranteed by the deceased spouse.

1. SECTION 294(d) NOTICE

Accordingly, if the claim is an unsecured claim for money, the personal representative should be able to give to the creditor the Section 294(d) notice, thereby triggering the 4 month bar rule as against the decedent's estate. If the personal representative wishes to send the notice and trigger the 4 month bar rule, it seems that the notice would need to inform the creditor of the relationship of the deceased spouse and the surviving spouse, if the relationship is not obvious under the circumstances. For example, the couple is John and Jane Smith, or John Smith and Jane Jones (she retained her maiden name); Jane purchases necessities on credit or incurs a co-pay at the emergency room in her name, not as Mrs. John Smith; John dies and John's personal representative sends the 294(d) notice to Jane's creditor under the heading of the "Estate of John Smith". How would the creditor associate the debt with John's estate? However, if proper notice is given and the creditor misses the shortened presentation deadline, is the claim against the surviving spouse barred as well? Probably not!

2. SECTION 295 NOTICE

If the joint debt is secured by an asset that is being administered by the personal representative (presumably their joint community or the deceased spouse's special community property), the personal representative should give the Section 295 notice to the secured creditor who, in turn, should be able to elect to treat the claim as a "matured, secured claim" or a "preferred debt and lien."

3. DEBT SECURED BY SURVIVOR'S PROPERTY

However, if the asset securing the joint debt is not being administered by the personal representative (presumably the surviving spouse's separate property or special community property), it would seem that the Section 295 notice is not required. Section 295(a) appears to direct the personal representative to give the notice only when the debt is secured by "real or personal property of the estate," arguably referring to the estate being by administered by the personal representative, not assets properly in the possession and control of the surviving spouse under Section 177.

Further, Section 306(a) grants to a secured creditor the right to elect to treat its debt as a matured, secured claim or a preferred debt and lien, if the creditor has a "secured claim for money against an estate," again arguably referring only to the estate being administered by the personal representative, not the surviving spouse under Section 177. However, if the creditor cannot present its claim as a matured, secured claim, thereby maintaining the ability to go after other assets of the decedent's estate, the creditor apparently loses the benefit of the deceased spouse's personal liability on the joint debt, presumably placing it in "preferred debt and lien" status in so far as the deceased spouse's estate is concerned. Accordingly, the creditor may not be able to make any further claims against the deceased spouse's separate property and one-half of other community assets. Of course, the creditor would still have its security interest in the asset, and the surviving spouse would still have personal liability.

4. ALTERNATIVE APPROACH

Alternatively, the proper approach may be to interpret Sections 295 and 306 to require the personal representative to give the Section 295 notice to secured creditors if the decedent had personal liability on the debt even if the asset securing the debt is the surviving spouse's separate property or special community property being administered by the surviving spouse under Section 177. Section 306 would then authorize the creditor to treat the claim as a "matured, secured claim" to maintain access to the decedent's estate. This approach could be limited to circumstances where it is readily apparent that the creditor was depending on the personal liability of the deceased spouse when the loan was made (i.e. both spouses signed the note and the security interest, or where the deceased spouse guaranteed the secured debt of the surviving spouse).

5. EQUITABLE PRINCIPLES

Whether tort or contract, incurred prior to or during marriage, this type of creditor can pursue the debt against either the personal representative of the estate in due course of administration or the surviving spouse, or both. If pursued against the personal representative, such a debt should generally be paid out of the community property under the control of the personal representative. If the community is insufficient and the debt is paid out of the decedent's separate property, the personal representative should then seek "equitable reimbursement" from the surviving spouse. If the surviving spouse pays the debt out of the survivor's separate property, Section 3.203 suggests that an equitable adjustment should be made in the ultimate partition of the survivor's special community or the survivor should be able to seek "equitable reimbursement" out of the decedent's separate property or one-half of the community property under the control of the personal representative.

The rationale: Shouldn't both spouses bear proportionate responsibility? However, the exact nature of the debt should be considered

B. Survivor's Tort Debt

Prior to the deceased spouse's death, Section 3.202 of the Texas Family Code clearly provides that all of the community property is liable for the tort debts of either spouse.

1. <u>EFFECT OF DECEDENT'S DEATH</u>

However, Sec. 156 of the Texas Probate Code provides that the decedent's special community property and the joint community property remain liable for the debts of the deceased spouse, whether in contract or tort. In addition, Section 156 states that the decedent's one-half interest in the surviving spouse's special community property is liable for the deceased spouse's debts. During the marriage, one hundred percent of a spouse's special community property was generally not liable for the contractual debts of the other spouse. Obviously, the death of a spouse changes the family code's marital liability rules; here the change benefits the decedent's creditors to the detriment of the deceased spouse's heirs and /or devisees.

2. TORT CREDITOR

Accordingly, did the deceased spouse's death create an exemption from the surviving spouse's tort creditors for the decedent's one-half interest in the community property? Arguably so, under Section 37 the decedent's separate property and one-half interest in the community property (whether the wife's special community, the husband's special community or their joint community property) passes to the deceased spouse's heirs and/or devisees subject only to the debts of the deceased spouse. The surviving spouse's tort debt is not a debt of the deceased spouse.

3. THE ARGUMENT

Section 156 then directs the personal representative on how to pay the deceased spouse's liabilities (or the debts that were enforceable against such deceased spouse), and it is submitted that debts that were enforceable against such deceased spouse refer to debts for which the deceased spouse had personal liability and not to debts that could have been paid out of the deceased spouse's property during the marriage. Accordingly, the surviving spouse's tort debts were not debts of the deceased spouse, and while any community property could have been reached by the creditor prior to the deceased spouse's death, it appears that the surviving spouse's tort debt is not a debt to be paid by the personal representative, since the deceased spouse did not have any personal liability for the debt.

4. EQUITABLE PRINCIPLES

If the decedent's one-half of the community property continues to be liable for the surviving spouse's tort debts and if the personal representative of the deceased spouse pays such debts out of the decedent's one-half of the community or out of the decedent's separate property, Sec. 3.203 suggests that an equitable adjustment in the partition and distribution of the remaining community property is appropriate. Alternatively, the personal representative should consider a reimbursement action against the surviving spouse.

C. Survivor's Contractual Debts

Prior to the deceased spouse's death, Section 3.202 provides that the surviving spouse's special community property and their joint community property were liable for the surviving spouse's contractual debts. deceased spouse's special community property was generally exempt from the surviving spouse's contractual debts. For the reasons discussed in B, supra, Sections 37 and 156 appear to maintain the family code's exemption from the surviving spouse's contractual creditors for the decedent's one-half interest in the deceased spouse's special community property. However, it is submitted that the deceased spouse's one-half interest in the rest of the community passes to the deceased spouse's heirs and/or devisees, free of the unsecured contractual debts of the surviving spouse; here the decedent's death appears to cause a detriment to the creditor in favor of the decedent's heirs and/or devisees.

On the other hand, the surviving spouse's one-half interest in all of the community is now available to the surviving spouse's creditors. In addition, to the extent the surviving spouse inherits all or any part of the deceased spouse's separate property or one-half of the community, the inheritance is reachable by the surviving spouse's creditors, unless the inheritance passes into a spendthrift trust for the benefit of the surviving spouse.

D. Survivor's Secured Debts

If the surviving spouse's contractual debt is secured by the surviving spouse's separate property, the approach described in C, *supra*, would appear to be applicable. However, if the debt is secured by the surviving spouse's special community party, the deceased spouse's one-half

interest in the special community property of the surviving spouse which secures the debt would pass to the deceased spouse's heirs and devisees, but it is still encumbered by the debt. However, since the deceased spouse had no personal liability on the debt, the personal representative would appear not to have any obligation to give the Section 295 notice or to satisfy the debt. Consequently, it would appear that the creditor would not be able to elect to treat the debt as a matured, secured claim, since the debt is not a debt of the deceased spouse. If the personal representative does pay the debt, Section 3.203 suggests that the personal representative should make an equitable adjustment as part of the partition and distribution of the remaining community assets or seek reimbursement from the surviving spouse.

E. Survivor's Pre-Marriage Debt

According to Section 3.202 of the Texas Family Code, a debt incurred prior to marriage, whether contractual or tortious in nature, is to be handled during the marriage in the same way as a contractual debt incurred by the spouse during the marriage. Accordingly, for any pre-marriage debt of the surviving spouse, refer to the discussion in C and D, above.

XI. REIMBURSEMENT AND ECONOMIC CONTRIBUTION

The last twenty-five years have seen several important cases which have specifically added to the evolvement of the equitable concept of reimbursement between the marital estates that usually arises when one spouse's separate property is improved through the expenditure of community funds or community time, talent and labor. The increased importance of this concept is due to the *Cameron v. Cameron*, 641 S.W.2d 210 (Tex. 1982) and *Eggemeyer v. Eggemeyer*, 554 S.W.2d 137 (Tex. 1977) cases.

A. Claim of Reimbursement

The law related to reimbursement evolved very slowly from the first case addressing the issue, *Rice v. Rice*, 21 Tex. 58 (1858), until 1982. During that period of time, the Texas courts would apply the equitable theory of reimbursement to recompense one marital estate, usually the wife's separate property or the community estate, when funds from that estate were utilized to benefit another marital estate, usually the husband's separate property.

B. Measure of Reimbursement

Once the right of reimbursement was found to exist, the Texas courts have not been very precise in determining the measure of reimbursement. Over the years three distinctive means of measurement evolved.

1. "COST OF THE IMPROVEMENT"

In *Rice*, the Texas Supreme Court held that the measure of reimbursement was the original cost of the improvement paid for by the community.

2. "ENHANCED VALUE OF THE IMPROVEMENT"

In Clift v. Clift, 72 Tex. 144, 10 S.W. 338 (1888), the Texas Supreme Court applied a measure of reimbursement based on the <u>enhanced value</u> of the property at the time of the dissolution of the marriage due to the improvement paid for by the community.

3. "LESSER OF COST OR ENHANCED VALUE"

In *Dakan v. Dakan*, 125 Tex. 305, 83 S.W.2d 620 (1935), the Texas Supreme Court seemed to favor a method of reimbursement which would compensate the community for either the <u>cost</u> of the improvement or the <u>enhanced value</u>, whichever was less.

C. Application at Death

The Dakan court also held that the community claim for reimbursement existed at the owner's death, thereby putting the surviving spouse to an equitable election (i) to accept the benefits conferred in the will and waive the claim, or (ii) to assert the claim and waive the benefits under the will. It would also follow that the claim exists upon the death of the non-owner, thereby imposing a duty on the personal representative to pursue the claim against the surviving owner/spouse.

D. Case Law Developments

There have been several cases since *Cameron* and *Eggemeyer* which have significantly added to the concept of reimbursement.

1. VALLONE

In Vallone v. Vallone, 644 S.W.2d 455 (1982), the Texas Supreme Court expanded the concept of reimbursement to include situations where one spouse, the owner of the business, had expended an inordinate amount of uncompensated community time, talent and labor to increase the value of the owner's separately owned closely held corporation.

2. <u>COOK</u>

In Cook v. Cook, 665 S.W.2d 161 (Tex. Civ. App.—Ft. Worth 1983, writ ref'd n.r.e.), the court of appeals neatly categorized a number of situations where the right of reimbursement can arise involving one spouse's separate real estate.

a. "Principal Reduction"

Wherever one spouse uses the property of one marital estate to retire the principal of a previously existing purchase money debt of an asset of another marital estate, the contributing estate is entitled to recover its share of the exact dollar amount contributed, regardless

of the underlying asset's increase in value. But, see the Penick case, infra.

b. "Interest and Taxes"

Wherever one marital estate contributes funds to pay either the interest on the purchase money indebtedness secured by an asset of another marital estate or the ad valorem taxes owing due to such asset, a balancing test is applied to determine whether the contributing estate enjoyed the current benefits of income or occupancy as quid pro quo for the payment of current expenses.

c. "Improvements"

Whenever one marital estate expends funds to improve the assets of another estate, the contributing estate is to be reimbursed for the enhancement in value due to the expenditure as provided in the *Clift* case. *See* the *Anderson* case, *infra*.

3. JENSEN

In Jensen v. Jensen, 665 S.W.2d 107 (Tex. 1984), the Texas Supreme Court reinforced the principle that the expenditure of community time, talent and labor by one spouse on separate property does not convert separate property into community property except in very limited situations. See Norris v. Vaughan, 152 Tex. 491, 260 S.W.2d 676 (Tex. 1953). Nevertheless, the expenditure of community time, talent and labor in excess of what is necessary to reasonably manage one's separate property can give rise to a community right of reimbursement to the extent that excess time, talent or labor is not compensated. The Court did not provide a precise measure of reimbursement.

4. ANDERSON

In Anderson v. Gilliland, 684 S.W.2d 673 (1985), the community had expended approximately \$20,000 to build a home on the separate property of the husband. At the time of the husband's death, the home was found to have enhanced the husband's separate property by \$54,000. The Supreme Court stated:

We hold that a claim for reimbursement for funds expended by an estate for improvements to another estate is to be measured by the enhancement in value to the benefitted estate. This rule is more likely to insure equitable treatment of both the contributing and benefitted estates in most situations. [emphasis added]

5. PENICK

In *Penick v. Penick*, 783 S.W.2d 194 (Tex. 1988), the Supreme Court held that advancements of community funds to either reduce the principal on purchase money indebtedness secured by separate property or to make capital improvements on separate property are to be measured by the same test – the enhancement in value to the benefitted estate. In addition, the Court directed the trial court to take into consideration benefits received in return by the community estate. How does paying off the

balance of a note payable enhance the value of the pledged assets?

6. HEGGEN

Although it is in the nature of a claim against the individual spouse, a reimbursement claim can be secured by the court imposing an equitable lien against the property benefitted. An equitable lien can even be imposed on the residential homestead to secure reimbursement for community funds expended for taxes, purchase money or improvements. *Heggen v. Pemelton*, 836 S.W.2d 145 (Tex. 1992)

Note: The 1995 amendments to the Texas Constitution expanded the types of debts that can be secured by the homestead.

7. OTHER CASES

There have been a number of cases citing Vallone, Jensen and Anderson. See generally Allen v. Allen, 704 S.W.2d 600 (Tex. App.—Ft. Worth 1986, no writ); Hernandez v. Hernandez, 703 S.W.2d 250 (Tex. App.—Corpus Christi 1985, no writ); Wren v. Wren, 702 S.W.2d 250 (Tex. App.—Houston [1st Dist.] 1985, writ dismissed w.o.j.); Jones v. Jones, 699 S.W.2d 583 (Tex. App.—Texarkana 1985, no writ); Zisblatt v. Zisblatt, 693 S.W.2d 944 (Tex. App.—Fort Worth 1985, writ dism'd w.o.j.). In Jacobs v. Jacobs, 687 S.W.2d 731 (Tex. 1985), the Supreme Court addressed the proof issues related to Vallone and Jensen. One court of appeals case, Trawick v. Trawick, 671 S.W.2d 105 (Tex. App.—El Paso 1984, no writ) appears to extend Vallone and Jensen to estate administration situations.

E. Additional Applications

1. LIFE INSURANCE

Reimbursement can arise in other situations. One of the more common situations is where one spouse owns separately an insurance policy on that spouse's life and uses community property to pay the premiums; upon the insured spouse's death, the proceeds are payable to a third party. In *McCurdy v. McCurdy*, 372 S.W.2d 381, (Tex. Civ. App.—Waco 1963, writ ref'd), the court held that the community was entitled to reimbursement in the amount of the premiums paid by the community.

2. OTHER APPLICATIONS

It does not appear that Anderson changes or should change the measure of reimbursement for either a Jensen or McCurdy situation. It should also be recognized that the Vallone and Jensen type of reimbursement may exist in a situation where the non-owner spouse expends an inordinate amount of uncompensated community time, talent and labor to enhance the separate property of the other spouse. As in Jensen, the focus should be on the value of the services rendered and actual compensation received. For further study, see Weekley,

"Reimbursement Between Separate and Community Estates," 39 Baylor Law Review 945 (1987).

F. Legislation

The 1999 legislature added a new Subchapter E to Chapter 3 of the Texas Family Code and created, in effect, a new type of reimbursement - "statutory reimbursement."

1. 1999 LEGISLATION

Financial contributions made with community property that enhanced the value of separate property during the marriage created an "equitable interest" of the community estate in the separate property. Tex. Fam. Code Sec. 3.401 (1999)

a. Equitable Interest Defined

However, an equitable interest did not create an ownership interest; it created a claim against the spouse who owns the property that matured on the termination of the marriage. Tex. Fam. Code Sec. 3.006(b) (1999). Compare, however, the language in Sec. 3.403(b) (1999), and note the inconsistency.

b. Amount of Claim

The claim was measured by the "net amount of the enhancement" in value of the separate property during the marriage. Tex. Fam. Code Sec. 3.401(b) (1999). If community funds were used to discharge all or a part of a debt on separate property, the statute described a formula to compute the amount of the claim. Tex. Fam. Code Sec. 3.402 (1999).

c. Equitable Lien

The court was instructed to impose an equitable lien to secure the claim. The statute also indicated that the lien could be assessed against other assets as well. Tex. Fam. Code Sec. 3.406 (1999).

d. No Offsetting Benefits

Where statutory reimbursement is appropriate, the use and enjoyment of the property during marriage did not create offsetting benefits. Tex. Fam. Code Sec. 3.405 (1999).

e. Life Insurance

The 1999 statute raised serious questions related to its application to life insurance situations. For example, where there was a separately owned policy, but community funds were used to pay some of the premiums, was this a Sec. 3.401 (1999) financial contribution? Did Sec. 3.401(b) (1999) or Sec. 3.402 (1999) apply? Or did the *McCurdy* case still apply?

f. Effective Date

According to language in the statute, the changes in law made by the relevant portions of the Act, HB 734, apply only to a suit for dissolution of a marriage pending on September 1, 1999, or filed on or after that date. Did

this mean that statutory reimbursement was limited to divorce actions? Following the death of a spouse, a reimbursement claim may arise in a probate proceeding, or in an independent cause of action. Most commentators believed it applied in probate situations.

2. 2001 LEGISLATION

HB 1245 (2001) contained a major overhaul to subchapter E. For example, statutory reimbursement is no longer referred to as an "equitable interest." It is more accurately referred to as a "claim for economic contribution."

Note: At the time this article was written HB 2565 and HB 2566 were pending in the legislature. These bills would eliminate "claims for economic contribution" and replace them with claims for reimbursement.

a. Intent

Section 1 of HB 1245 clearly states that economic contributions by one marital estate for the benefit of another creates a claim for the contributing marital estate in the property of the benefitted estate—"claim for economic contribution."

b. Economic Contribution Defined

Economic contributions arise in six statutorily defined situations related to use of one marital estate's funds to reduce the principal amount of debt secured by another marital estate or to make capital improvements to another marital estate. Tex. Fam. Code Sec. 3.402(a). Economic contribution does not include expenditures for ordinary maintenance or repair, or for taxes, interest or insurance, or for the contribution of time, toil, talent or effort (i.e., Jensen type claims). Tex. Fam. Code Sec. 3.402(b).

c. New Formula

Sec. 3.403(h) describes a new, and apparently workable, formula to be used in economic contribution situations. See Gagnon, Statutory Reimbursement: The Equitable Enigma," State Bar of Texas, Advanced Family Law Course, August 2001, and Goodman, "Guest Commentary," State Bar Section Report—Family Law, Vol. 2001-2 Summer.

<u>Note</u>: The new formula allows the claim to participate in the benefitted property's appreciation or depreciation. Discussion among some family law experts suggests that the application of the new formula may render the formula unconstitutional as a conversion of separate property into community property by a means not authorized by Art. XVI, Sec. 15.

d. Use and Enjoyment

The use and enjoyment of the property during marriage does not create a claim of an offsetting benefit. Tex. Fam. Code Sec. 3.403(e). Obviously, the couple's

occupancy of the separate property home of the husband that was improved with community funds is not an offset. However, if the property is income producing, or generating tax benefits, shouldn't that benefit to the community offset the claim for economic contribution?

<u>Note</u>: The statute uses the language "use and enjoyment," not "use and benefit."

e. Surviving Spouse's Election

If the owner spouse devises the benefitted separate property to the other spouse, the other spouse should not be able to accept the devise and also assert a claim for economic contribution. The correct analysis may be to explain that the surviving spouse is put to an election. Even if the benefitted property is devised to a third party, the other spouse may have to elect between accepting what other assets were devised to him or her and asserting the claim for economic contribution. See XII, E supra.

f. Equitable Lien

In divorce situations, an equitable lien is imposed to secure payment of the claim. In death situations, a party of interest must request the imposition of the equitable lien. Tex. Fam. Code 3.406.

<u>Note</u>: The equitable lien can be imposed on any assets of the owner of the benefitted property; the court is not limited to the benefitted property itself.

g. Claims for Reimbursement

The claim for economic contribution does not eliminate from Texas law the traditional claim for reimbursement except in those fact situations that are statutorily defined claims for economic contributions. Tex. Fam. Code Sec.3.408(a). In fact, the statute gives examples of the more traditional claim for reimbursement—payment of unsecured liabilities and Jensen type claims. Tex. Fam Code Sec. 3.408(b). Claims for reimbursement are to be resolved using equitable principles, including "use and enjoyment" offsets. Tex. Fam. Code Sec.Sec. 3.408@ and (d). A 2007 amendment to the section places the burden of proof on the party seeking the offset. Tex. Fam. Code Sec. 3.408(e). The statute does describe some nonreimbursable claims—payment of child support, alimony or spousal maintenance, living expenses of a spouse or child, contributions or principal reductions of nominal amounts, and student loan payments. Tex. Fam. Code Sec. 3.409. Despite some apparent confusion on the part of some courts (see Lewis v. Lewis, 1999 Tex. App. LEXIS 4920, (Tex. App.—Houston [1st Dist., no pet], "waste of community assets" should be considered as a type of fraud on the community, not a claim for reimbursement. See V., B, supra.

h. Marital Property Agreement

Marital property agreements executed before or after September 1, 1999, the effective date of the 1999 legislation, which waive or partition traditional reimbursement claims will be effective to waive claims for economic contribution. Tex. Fam. Code Sec. 3.410.

G. Death of Non-Owner Spouse

Upon the death of the non-owner spouse, the non-owner spouse's one-half interest in the community claim for reimbursement or economic contribution would pass to that spouse's heirs or devisees.

1. DUTY OF PERSONAL REPRESENTATIVE

If the sole heir or devisee is not the owner spouse or if the estate is insolvent, the personal representative would appear to be under a duty to pursue the claim against the owner spouse.

2. LIQUIDITY PROBLEMS

The existence of the claim may result in a much larger estate than had been anticipated. The deceased spouse's interest in the claim would be included in the deceased spouse's gross estate for death tax purposes and may cause an immediate liquidity problem.

3. CONFLICT OF INTERESTS

The existence of the claim may create a conflict of interest for both the personal representative and the attorney who are attempting to represent the entire family.

H. Death of Owner Spouse

Upon the death of the owner spouse, the asset which is the subject of the community claim for reimbursement or economic contribution will remain the owner's separate property and pass under the owner's will or by intestate succession; however, the claim continues to exist.

1. <u>CONFLICT OF INTERESTS</u>

Such a situation can create a conflict of interest (i) between the surviving spouse and the decedent's heirs or devisees where the surviving spouse is not the sole heir or devisee or (ii) between the heirs or devisees where the heirs or devisees of the separate property are not the same as the heirs or devisees of the community property. This potential conflict can be particularly troublesome for the personal representative or attorney who attempts to represent all members of the family.

2. <u>ELECTION</u>

As explained in *Dakan*, the doctrine of equitable election may force the surviving spouse to (i) assert the claim and waive any and all benefits under the will or (ii) accept the benefits conferred in the will and forego the claim. The doctrine of equitable election is applied where any devisee receives a benefit and suffers a detriment in a will. Accordingly, the election concept might work against any party involved.

3. OTHER PROBLEMS

The existence of such a claim with an uncertain value is likely to delay the administration of the estate and create liquidity problems.

XII. CONCLUSION

2009 marks the 40th anniversary of the enactment of the original version of the Texas Family Code which codified the revolutionary new concepts found in the Matrimonial Property Act of 1967 and which ushered into Texas law a new era of marital property liability. It is time that Texas courts factor into their decision marking, as well as incorporate into their opinions, the "new" law. Continued reliance on the "old" law (i.e., a cite to a pre-1967 case as authority when the new law would change the result) creates confusion among practitioners and the public alike. The legislature has laid the foundation for a logical, workable structure. If only the courts would build upon that foundation, rather than ignoring the structure of the legislative mandate.

Hypothetical

Pat and Kris were married in 1999. It was each spouse's second marriage; each had adult children by a prior marriage. Pat died recently, survived by Kris and Pat's two children, Jenna and Barbara. Pat's simple will, executed 2003, named Jenna, as the independent executor, and devised the home, its furnishings and furniture, and the personal effects to Kris and the residuary estate to Jenna and Barbara.

Note: According to Sec. 37, Pat's separate property and Pat's ½ of any community property vested in Pat's devisees subject to Pat's debts, not Kris' debts.

I. The marital estate

- A. Pat's separate property (PSP) - "Pat"
 - 1. Blackacre, f/m/v \$500K, debt \$250K
 - 2. ABC common stock, f/m/v \$1M
 - 3. Partnership, insolvent, f/m/v -0-
- B. Kris' separate property (KSP) - "Kris"
 - 1. Whiteacre, f/m/v \$400K, debt \$200K
 - 2. DEF common stock, f/m/v \$1M
- C. Their joint community property (JCP) - "Pat and Kris"
 - 1. Greenacre, f/m/v \$1M, debt \$600K
 - 2. GHI common stock, f/m/v \$1M
 - 3. Home, f/m/v \$600K, debt \$400K
 - 4. Personalty, f/v/v \$100K
- D. Pat's special community property (PCP) - "Pat"
 - 1. Purpleacre, f/m/v \$800K, debt \$500K
 - 2. JKL common stock, f/m/v \$1M
- E. Kris' special community property (KCP) - "Kris"
 - 1. Redacre, f/m/v \$800K, debt \$600K
 - 2. MNO common stock, f/m/v \$1M.

II. Sec. 177 administration

- A. Jenna's control
 - 1. Blackacre (PSP) 4. ABC stock (PSP)
 - 2. Greenacre (JCP) 5. GHI stock (JCP)
 - 3. Purpleacre (PCP) 6. JKL stock (PCP)
- B. Kris' control
 - 1. Whiteacre (KSP) 3. DEF stock (KSP)
 - 2. Redacre (KCP) 4. MNO stock (KCP)
- C. Not subject to administration
 - 1. Home (JCP)
 - 2. Personalty (JCP)
 - 3. Joint bank accounts (non-probate to Kris)
 - 4. Life insurance (non-probate to Kris)
 - 5. Retirement plans (non probate to Kris)

III. Debts of Pat and Kris

- A. "Community Debts" [THERE'S NO SUCH THING]
- B. Joint debts of Pat and Kris
 - 1. Home mortgage, \$400K
 - 2. Hospital bills, \$100K
 - 3. Credit cards, \$50K
- C. Pat's debts
 - 1. PSP mortgage, \$250K
 - 2. PCP mortgage, \$500K
 - 3. Partnership guarantee, \$200K
 - 4. Auto accident, \$200K
- D. Kris' debts
 - 1. KSP mortgage, \$200K
 - 2. KCP mortgage, \$600K
 - 3. Unsecured note, \$100K
 - 4. Malpractice, \$400K

Note: Both Pat and Kris were personally liable for the joint debts. Kris did not have any personal liability for Pat's debts. Pat did not have any personal liability for Kris' debts

- IV. Sec. 156 liability for debts where Pat had personal liability
 - A. Pat's separate property
 - 1. ABC stock
 - 2. Blackacre
 - B. Pat's special community property (100%)
 - 1. JKL stock
 - 2. Purpleacre
 - C. Joint community property (100%)
 - 1. GHI stock
 - 2. Greenacre
 - D. Kris' special community
 - 1. MNO stock (only Pat's ½)
 - 2. Redacre (only Pat's ½)
- V. Paying Pat's personal liability debts
- Note 1: After receiving the Sec. 295 notice and pursuant to Sec. 306, Pat's secured creditors (PSP and PCP) elected "matured, secured" and the "joint" secured creditors (JCP) also elected "matured, secured." Kris' secured creditors were not entitled to receive the Sec. 295 notice since they did not have a claim for money against Pat's estate that was secured by property of the estate being administered by Jenna. Consequently, it follows that they cannot elect "matured, secured" under Sec. 306 (the debtor Kris is still alive).
 - A. Sell ABC stock (PSP)
 - 1. Blackacre debt, \$250K
 - 2. Partnership guarantee, \$100K
 - 3. Auto accident, \$200K
 - B. Sell GHI or JKL stock (JCP, PCP)
 - 1. Home mortgage, \$400K
 - 2. Greenacre mortgage, \$600K
 - 3. Purpleacre mortgage, \$500K
 - 4. Hospital bills, \$100K
 - 5. Credit cards, \$50K
- Note 2: When GHI or JKI stock is sold, both Pat's and Kris' halves are sold to satisfy their joint debts or debts incurred to acquire community property subject to the executor's control during administration (PCP/JCP).
- Note 3: Pat's funeral expenses should be paid out of Pat's separate property or Pat's one-half of (i) Pat's special community property or (ii) the joint community (Sec. 320A).

 Administration expenses should be allocated among the community and separate assets under the executor's control as appropriate.

VI. Kris' debts

- A. Whiteacre (KSP) mortgage, \$200K
- B. Redacre (KCP) mortgage, \$600K
- C. Unsecured note, \$100K
- D. Malpractice, \$400K
- Note 1: These debts are not the executor's responsibility. The Whiteacre mortgage was incurred by Kris prior to marriage. The other three, though incurred by Kris during the marriage, are not "community debts"; they were not Pat's debts; Pat did not have any personal liability; they are Kris' debts.
- Note 2: Pat's ½ interest in Redacre (KCP) passes to Jenna and Barbara encumbered by its mortgage but Jenna and Barbara don't assume any personal liability for Kris' debts. Had Pat's ½ been specifically devised to Jenna and Barbara, they would have been entitled to receive it, "free of debt." (Will was executed prior to the effective date of Sec. 71A) In that event, the executor should pay the debt out of 100% of the community under its control, the GHI or JKL stock.

VII. What's left for Jenna and Barbara?

A. ABC stock (PSP)

\$1,000,000

- 250,000 (Blackacre mortgage)
- 200,000 (partnership guarantee)
- <u>- 200,000</u> (auto accident)

\$ 350,000

B. GHI and JKL stock (JCP, PCP)

\$2,000,000

- 400,000 (home mortgage)
- 500,000 (Purpleacres mortgage)
- 100,000 (hospital)
- <u>- 50,000</u> (credit cards)

\$ 950,000

Less $\sqrt{$475,000}$ (Kris $\frac{1}{2}$)

\$ 475,000

C. Real Property

- 1. Blackacre, \$500,000
- 2. ½ Purpleacre, \$400,000
- 3. ½ Greenacre, \$500,000
- 4. ½ Redacre, \$100,000 (\$800K-600K x ½) \$1,500,000

D. ½ of MNO stock (KCP), \$500,000

E. Total \$2,825,000

VIII. What's left for Kris?

A.	Whiteacre	\$200,000 (\$400K-200K)
B.	DEF stock	\$1,000,000
C.	Home	\$600,000
D.	Personalty	\$100,000
E.	½ MNO stock	\$500,000
F.	½ Greenacre	\$500,000
G.	½ Purpleacre	\$400,000
H.	½ Redacre	\$100,000 (800K-600K x ½)
I.	½ GHI, JKL stock	\$\\$475,000
		\$3,875,000(plus non probate assets)

IX. What if?

A. Assume the value of the ABC stock (PSP) would have been only \$600,000, rather than \$1,000,000, and Jenna would have sold \$50,000 of JKL stock (PCP) to pay the balance of the debts that would have been otherwise paid out of Pat's separate property... shouldn't an equitable adjustment be made in the partition and distribution of the remaining GHI and JKL stock (JCP, PCP) so that Kris receives \$500,000 of such stock and Jenna and Barbara receive \$450,000?

If balance of the GHI and JKL stock would have been sold to satisfy such a debt, shouldn't Kris be reimbursed out of the ABC stock (PSP)? Alternatively, an adjustment should be made in the partition and distribution of the MNO stock?

B. Assume the value of the GHI and JKL stock (JCP, PCP) would have been only \$1,000,000 rather than \$2,000,000 and Jenna used \$50,000 of the ABC stock (PSP) to pay the balance of the debts that would have paid otherwise with community funds.... shouldn't there be an "equitable adjustment" in the partition and distribution of the \$1,000,000 MNO stock (KCP) so that Jenna and Barbara receive \$525,000 of the MNO stock and Kris retains \$475,000 of the MNO stock?

Alternatively, shouldn't Kris "reimburse" Jenna and Barbara for the \$25,000 of "their money" that was used to satisfy Kris' share of the joint debts of Pat and Kris?