

# **MARITAL PROPERTY LIABILITY LAW**

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## I. INTRODUCTION

Statements in a recent opinion, *Aldrich v. Teddler*, 2011 WL 3546589 (Tex. App.—Fort Worth, August 1, 2011), similar to language found in many other Texas cases involving marital property liability, continue to create confusion for lawyers and the public. In *Aldrich*, plaintiff, a law firm, filed suit against a husband and wife during their divorce proceedings, seeking to recover the legal fees for having represented the wife earlier in the proceedings. The divorce court awarded the firm a judgment solely against the wife and ordered the wife to pay the fees as part of the division of the marital estate.

The wife later filed for bankruptcy, and the law firm then filed suit to establish the now ex-husband's personal liability for the unpaid fees. The trial court held that he was not personally liable, but the court of appeals rendered judgment that the now divorced husband and wife were still jointly and severally liable for the fees.

### A. The Real Issue

Specific authority for the end result exists. A spouse is personally liable for the "necessaries" of the other spouse. Tex. Fam. Code §§ 2:501, 3:201(a)(2). Case law also exists which suggests that the attorney's fees of a spouse incurred in good faith and with probable cause may be considered "necessaries." *Navarro v. Brannon*, 616 S.W.2d 262, 263 (Tex. Civ. App.—Houston [1<sup>st</sup> Div.] 1981, writ ref'd. n.r.e.); *Roberts v. Roberts*, 193 S.W.2d 707, 709 (Tex. Civ. App.—Dallas 1945, no writ). If both spouses are personally liable, their nonexempt separate property and their nonexempt community property can be

reached by the creditor to satisfy the debt. Tex. Fam. Code § 3.202. The subsequent divorce of the parties does not affect the rights of the creditor. *Blake v. Amoco Federal Credit Union*, 900 S.W.2d 108, 111-112 (Tex. App.—Houston [14<sup>th</sup> Dist] 1995, no writ).

*Note: Professor Paulsen, in his excellent article on post-divorce liability, challenges what most have assumed to be established Texas law; divorce cannot prejudice the rights of preexisting creditors. He argues that such a rule ". . . lacks any modern legal justification, and subverts the intent of the Texas Constitution and Family Code." He encourages the Texas Supreme Court to declare that ". . . an unsecured creditor . . . has no special rights against a former spouse or that spouse's property once the marriage ends." See James W. Paulsen, "The Unsecured Texas Creditor's Post-Divorce Claim to Former Community Property," 63 Baylor Law Review 781 (2011).*

### B. The Court Said What??? . . .

Rather than focusing exclusively on what should be the real issue – whether the legal fees in question were "necessaries" under the Texas Family Code – in *Aldrich*, the court stated that the fees were a "community debt," thus triggering joint and several liability of both spouses. It is not surprising that, in its Petition for Review to the Texas Supreme Court, the Petitioner criticizes the Court's reliance on the "community debt theory." Petition for Review, p. 6. Surprisingly, the Respondent doesn't appear to really disagree with the Petitioner on the community debt argument. "The Court's holding on necessaries made superfluous its comment that debts contracted during the marriage are presumed to be community." Respondent Brief, p. 7.

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Petitioner then argues that the Court's reliance on the "community debt theory" is plain error and calls on the Texas Supreme Court to correct it. Petitioner's Response Brief, p. 7. This author agrees; it is time for Texas courts to consistently follow the legislative mandate found in the Texas Family Code addressing marital property liabilities.

### *C. Arnold v. Leonard*

Years ago, the Supreme Court of Texas in *Arnold v. Leonard*, 114 Tex. 535, 273 S.W. 799 (1925) tried to make it clear to practitioners and the Legislature that it is the Texas Constitution which ultimately defines what is separate or community property. However, unlike characterization rules, the Court explained 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."

### **D. Matrimonial Property Act of 1967**

Early in Texas history, the husband managed not only the community property of the marriage but also the separate property of both spouses. Beginning in 1913, emancipation led to a gradual expansion of the wife's right to manage her own separate property and to participate in managing the community property.

#### 1. The Old "New" Management Rules

Eventually, both spouses were granted separate but equal rights in the

management of their respective separate properties in the Matrimonial Property Act of 1967. This landmark 1967 legislation also granted women for the first time equal rights with their husbands in the management of their community property. These concepts were then codified as Sections 5.61 and 5.62 of the Texas Family Code enacted in 1969, effective Jan. 1, 1970, and are currently codified 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).

#### 2. The Old "New" Liability Rules

Prior to the Matrimonial Property Act of 1967, Texas marital liability 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*. These rules also changed when the Legislature passed the Matrimonial Property Act of 1967 and codified its concepts into the Texas Family Code. The liability rules are currently found in Sections 3.202 and 3.203 of the Texas Family Code. See III, *infra*.

### **E. Community Debt**

As a result, there no longer exists "community debt" in Texas. A debt is either the debt of the husband, or of the wife, or of the husband and the wife. The community is not an entity that can own property or incur debt. Nevertheless, too many cases still demonstrate that some courts (sometimes, even the Texas Supreme Court itself – *Stewart Title Company v.*

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*Huddleston*, 608 S.W.2d 611 (Tex. 1980)) “just don’t get it.” The Texas Legislature has prescribed a logical liability system that some courts continue to ignore. For example, in *Sprick v. Sprick*, 25 S.W.3d 7, 13 (Tex. App.—El Paso 1999, pet. denied), a case cited by the Court in *Aldrich*, that court states that debts contracted during the marriage are presumed to be “community debts” under Tex. Fam. Code § 3.003(a). *No, that section of the family code says property acquired during the marriage is presumed to be community property.* The court then goes on to say that the degree of proof required to rebut the presumption of community debt is clear and convincing evidence according to Tex. Fam. Code § 3.003(b). *No, that section clearly states that clear and convincing evidence is necessary to rebut the presumption that an item of property is community property! A debt owing by a spouse is not the property of the spouse!*

## II. MARITAL PROPERTY MANAGEMENT

The Texas Family Code prescribes which spouse has management powers over the marital assets during the marriage.

### A. Statutory Rules

#### 1. Separate Property

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

#### 2. Sole Management Community

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 § 3.102(a).

#### 3. Joint Management Community

All other community property is subject to both spouses' joint management, control and disposition – “the joint community property.” Tex. Fam. Code § 3.102(c). This status can result from the “mixing” of his and her sole management community assets. Tex. Fam. Code § 3.102(b).

### B. 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.”

### C. Presumptions

In addition to the community presumption of Section 3.003, an asset titled in one spouse’s name (or untitled but in the sole possession of one spouse) is presumed to be subject to that spouse’s sole

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management and control. Tex. Fam. Code § 3.104. Thus, an asset held in either spouse's name is presumed to be that spouse's special community property. However, the actual definition of "special community property" is found in Tex. Fam. Code § 3.102(a). If an asset does not fall within the statutory definition of "sole, management community," it is "joint community," even if held in one spouse's name.

### D. Other Factors

#### 1. Power of Attorney

The Texas Family Code's powers of management can be modified by the parties through a power of attorney or other agreement. Tex. Fam. Code § 3.102. There is authority that suggests that such an agreement can be oral. *LeBlanc v. Waller*, 603 S.W.2d 265 (Tex. App.—Houston 1980, no writ). A durable power of attorney continues the authority of the agent even if the principal later becomes incapacitated. *See* Tex. Prob. Code §§ 482 and 484.

#### 2. Homestead

The Texas Family Code also prohibits the managing spouse from selling, conveying or encumbering the homestead without the joinder of the other spouse, even if the homestead is the managing spouse's separate property or special community property. Tex. Fam. Code § 5.001.

#### 3. Incapacity

In the event of the incapacity of the managing spouse as to special community, or (one of the spouses as to joint community property) the competent spouse may petition the probate court pursuant to Sec. 883 of the Texas Probate Code for authority to manage the entire community estate without a

guardianship. A guardianship may be needed for the incapacitated spouse's separate property.

## III. MARITAL PROPERTY LIABILITY

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

### A. Statutory Rules

#### 1. Separate Property Exemption

As a general rule, a spouse's separate property is not subject to the debts of the other spouse. Tex. Fam. Code § 3.202(a).

#### 2. Special Community Exemption

As a general rule, a spouse's special community property is not subject to any debts incurred by the other spouse prior to the marriage or any nontortious debts of the other spouse incurred during the marriage. Tex. Fam. Code § 3.202(b).

#### 3. Other Rules of Law

These two general rules apply unless both spouses are personally liable under "other rules of law." Tex. Fam. Code § 3.202(a) and (b).

#### 4. Exempt Property

Of course, the family homestead and certain items of personal property are generally exempt from the debts of both spouses, regardless of the marital character of the property. Tex. Prop. Code §§ 41.001 and 42.001. The Texas Property Code and Texas Insurance Code create exemptions for retirement benefits and life insurance.



5. Creditors' Rights

Accordingly, a spouse's nonexempt separate property and special community property are subject to any liabilities of that spouse incurred before or during the marriage. Nonexempt joint community is liable for the debts of either spouse. In addition, the nonexempt special community properties of both spouses are subject to the tortious liabilities of either spouse incurred during marriage. Tex. Fam. Code § 3.202 (c) and (d).

6. Order of Execution

A court 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 § 3.203.

**B. Record Title**

Whether a nonexempt asset is held in one spouse's name or in both spouses' names, it is presumptively community property, thereby placing the burden on a spouse claiming separate status to prove why it is separate property.

1. Management Presumption

If the community presumption is not rebutted, the fact that title is held in one spouse's name (or it's untitled, but in the sole possession of one spouse) creates a rebuttable presumption that the asset is the spouse's special community property and liable for that spouse's debts and the tort debts of the other spouse incurred during the

marriage, but generally exempt from the other spouse's premarital debts and any non-tortious debts of the other spouse incurred during marriage.

2. Rebutting the Presumption

If the facts indicate that a community asset is not property the "titled" spouse would have owned, if single (e.g., personal earnings, income from separate property, increases and expenses from special community property), Section 3.102(c) indicates it is joint community and, therefore, liable for all debts of both spouses.

3. Mixing Special Community

If one spouse's special community is "mixed" with the other spouse's special community (or presumably their joint community), the "mixed" community is converted into joint community and subject to both spouses' debts. This result typically occurs when the spouses deposit their respective salaries into a joint account. If an asset is subsequently purchased with funds from the joint account and placed in one spouse's name (absent donative intent of the other spouse), the asset is presumptively subject to that spouse's sole management, but may be found to be joint community for liability purposes due to its traceable "joint" source.

4. The "Sole Management" Joint Account

If only one spouse deposits his or her special community funds into a joint account, the account is community property, and the account agreement will dictate who can write the checks or otherwise make withdrawals (typically, either spouse can write a check or make a withdrawal).

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However, if the other spouse's creditors attempt to subject it to the contractual debts of the non-depositing spouse, the depositing spouse has a good argument that the account is still the depositing spouse's special community property and exempt from other spouse's non-tort and any premarital creditors. A joint account belongs to the party who deposited the funds. Tex. Prob. Code § 438(a).

### C. Other Factors

The general rules described in III, A, *supra*, apply unless both spouses are personally liable under "other rules of law."

#### 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 the entire nonexempt marital estate to liability.

#### 2. Vicarious Liability

The law also defines other situations where any person can be held personally liable for debts 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, in and to itself, is not sufficient to generate vicarious liability. Tex. Fam. Code Sec. 3.201.

#### 3. "Necessaries"

In addition, 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 nonexempt marital assets are liable for such "necessaries."

#### 4. Effect of Obligor's Death

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; now the Family Code provides that court-ordered child support obligations survive the obligor's death. Tex. Fam. Code § 154.006. Subsequent amendments to the Family Code also provide that the obligor's child support obligations can be accelerated upon the obligor's death and a liquidated amount will be determined using discount analysis and other means. Tex. Fam. Code § 154.015. An amendment to the probate code makes the liquidated amount a class 4 claim. Tex. Prob. Code § 322. The court can also require that the child support obligation be secured by the purchase of a life insurance policy. Tex. Fam. Code § 154.016.

### D. Legislative Mandate

The bottom line is: The Legislature has prescribed a logical liability system utilizing a multiple-step process to determine which nonexempt marital assets are liable for which debts:

1. Whose debt is it? *It is either the debt of the husband, the debt of the wife or both spouses' debt.*
2. When was the debt incurred? *It was incurred either prior to or during the marriage.*

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3. What type of debt is it? *It is either tortious in nature or contractual.*
4. Are there any other substantive rules of law which would make one spouse personally liable for the debts of the other spouse? *The answer will depend on the facts and circumstances.*

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

### E. No Community Debt

The Texas Family Code's liability rules do not support the notion of a "community debt." The use of that term implies that (i) both spouses have personal liability for the debt and (ii) all nonexempt community property can be reached to satisfy the debt. Neither statement is necessarily true. The proper methodology is to follow the legislative mandate discussed in this Section III, D, *supra*. Please also refer to this author's paper, *Marital Property Liabilities: Dispelling the Myth of the Community Debt*, State Bar of Texas, Advanced Estate Planning and Probate Course, June, 2009, and the *Marital Property Liabilities: Dispelling the Myth of Community Debt*, Featherston and Dickson, *Texas Bar Journal*, January, 2010.

### F. Summary

Accordingly, absent a statutory exemption, a spouse's separate property and special community property, as well as the joint community property, are liable for that spouse's debts during the marriage. 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 may be exempt depending upon the circumstances).

If the debt is not a tort debt incurred during the marriage, the other spouse's separate property and special community property are exempt during the marriage 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.

*Note: However, the rules change when the first spouse dies. See V and VI, infra.*

## IV. THE SOURCE OF THE CONFUSION

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

### A. *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

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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. 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.

### 3. *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

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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 61<sup>st</sup>, 62<sup>nd</sup> and 63<sup>rd</sup> 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.

### **B. Anti-Cockerham Legislation**

1987 legislation should have been interpreted as putting an end to the *Cockerham* rules. Texas Family Code Sec. 3.201 was amended in response to *Cockerham* to provide 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 § 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. This legislation places 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).

### **C. Prof. McKnight's Explanation**

Almost thirty 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.*

*Note: Of course, Professor McKnight was instrumental in drafting 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.*

#### **D. Bottom Line**

Reliance on *Cockerham*, *Broussard* and *Gleich* (as well as numerous court of appeals' decisions that reference them), 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. DEATH OF SPOUSE**

When a married resident of Texas dies, the marriage terminates and community property ceases to exist. Nonprobate assets pass to their third party beneficiaries. Death works a legal partition of the *community probate assets*; the deceased spouse's undivided one-half interest passes to his heirs and/or devisees, and the surviving spouse retains her undivided one-half interest therein.

##### **A. Marital Liabilities**

But 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. There are no community debts. Not all of the debts were the debts of both spouses. 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 personal liability for any debts of the deceased spouse for which the survivor did not have preexisting personal liability. It is the deceased spouse's "estate" that may be liable for the deceased spouse's debts.

## 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 Fed. Savings & Loan Ass'n*, 639 S.W.2d 490, 491 (Tex. App. – Texarkana 1982, writ ref'd n.r.e.). "Possession, then, by an heir does not subject him to liability. He holds the property with the encumbrance, but he cannot 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. Probate v. Nonprobate

The "estate" of a decedent should initially be divided into two separate and distinct categories. Certain assets fall within the *probate* class and others are classified as *nonprobate* assets. An asset is nonprobate 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.

### 1. Nonprobate Transfers

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. Nonprobate assets remain liable for the decedent's debts unless there exists a statutory exemption like the one for life insurance policies under the Texas Insurance Code or the one for retirement benefits under the Texas Property Code. Tex. Prob. Code § 450(a) and (b).

### 2. Inter Vivos Gifts

In other nonprobate dispositions addressed by Section 450(b), 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. Of course, the typical inter vivos gift of the ownership and possession of an asset prior to the owner's death can be considered a nonprobate disposition and also subject to a fraud on the creditors analysis.

*Note: If the deceased spouse made a nonprobate disposition of his/her special community property to a third party, other liability issues are raised. See IX, infra.*

### 3. Probate

Probate assets are those assets which are not controlled by an inter vivos or nonprobate arrangement and pass at the owner's death to the owner's heirs or devisees, subject to possible probate administration. 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 nonprobate arrangement. The surviving spouse retains, not inherits, his or her undivided one-half interest in the community probate assets.

#### D. Section 37

The deceased spouse's probate "estate" generally passes to the deceased spouse's heirs and/or devisees *subject to the deceased spouse's debts*. Thus, the deceased spouse's separate property and one-half interest in the community property are generally 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).

#### E. Section 156

Section 156 of the Texas Probate Code states that the one-hundred percent (100%) of the community property subject to the sole control of the deceased spouse or joint control of both spouses 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. Section 156 does not refer to the surviving spouse's debts.

#### F. Administration of Community Property

In addition to collecting the probate 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 may include 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 a formal 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. *See VI, infra*.

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

*Note: If the deceased spouse died intestate and the surviving spouse is the sole heir, there may not be a need for any type of formal administration. Tex. Prob. Code Sec. 155.*

#### G. 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 §§ 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 § 45. The rules relating to “representation” were modified to be effective September 1, 1991. Tex. Prob Code § 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 § 38.

**H. 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 §§ 57 and 58. This broad grant of testamentary authority is, however, effectively limited to the testator's separate probate property and his or her undivided one-half interest in the community probate property. *Avery v. Johnson*, 108 Tex. 294, 192 S.W. 542 (1917).

*Note: If the surviving spouse is a beneficiary under the will, the testatory may be able to effectively expand his or her testamentary power to the entire marital estate through the doctrine of election. But the surviving spouse's consent is required.*

**I. 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 exist for the benefit of 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 § 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 § 278. There is also an allowance in lieu of exempt personal property. Tex. Prob. Code § 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 may be established by the probate court. Tex. Prob. Code §§ 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).

#### **J. Authority of Surviving Spouse – No 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 §§ 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."*

#### **VI. ADMINISTRATION OF DECEASED SPOUSE'S ESTATE**

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 may include 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

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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. Distribution of Powers

During formal administration, the personal representative is granted authority to administer 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 § 177.

#### 1. Authority of Representative

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 purports to grant 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.

#### 2. Comparison with Family Code Provisions

Section 177's division of authority dovetails with the contractual management

and liability rules of the Texas Family Code and facilitates the personal representative's or ability to step into the decedent's shoes and satisfy the deceased spouse's debts in most situations. Tex. Fam. Code §§ 3.102 and 3.202.

- (a) Contract Debts: However, if the community assets in possession of the personal representative and available to satisfy the deceased spouse's contractual creditors are insufficient for that purpose, Tex. Prob. Code § 156 indicates that the deceased spouse's one-half interest in the surviving spouse's special community property can be reached to satisfy those creditors. *One hundred percent of these assets had been generally exempt from the claims of the deceased spouse's non-tortious creditors during the marriage (as well as any premarriage debts).*
- (b) Tort Debts: Prior to the deceased spouse's death, all nonexempt community property was liable for the tort debts of either spouse. Section 156 suggests that only the decedent's one-half interest in the surviving spouse's special community may continue to be liable for any tort debts of the deceased spouse. *In other words, an argument can be made that the surviving spouse's one-half interest in the survivor's special community may no longer be liable for any tort debts of the deceased spouse.*

3. Authority of the Surviving Spouse

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 § 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 § 156.

*Note: Sections 156, 160 and 168 still refer to "community debts" and "community obligations" and carry forward from pre-1967/1971 law; however, as Professor McKnight explained, a "community debt" or "community obligation" should be interpreted to mean nothing more than some community property, or a portion thereof, is liable for its satisfaction. See III, infra.*

**B. 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 specifically address the debts of the surviving spouse

which are not debts of the deceased spouse. It also does not address the issues related to which assets subject to administration are liable for which debts.

2. Nonprobate Assets

In the past, many believed in the "urban myth": probate assets pass subject to the decedent's debts whereas nonprobate 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 that myth. See Tex. Prob. Code §§ 442, 450(b) and 461.

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 nonprobate 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 Generally

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 nonprobate 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. Tex. Prob. Code § 322B.

5. Abatement Among Community and Separate Assets

Sec. 320A directs a representative to pay the deceased spouse's funeral expenses out of the decedent's separate and one-half of the community, but Sec. 322B fails to give direction on how to pay 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?

6. General Guidelines

The author is not aware of any definitive cases on point that offer any clear guidance. Accordingly, it is the author's opinion that certain claims should be paid 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 deceased spouse. Other claims, like debts incurred for living expenses (e.g., credit cards and utilities), or for community property purchase money indebtedness, should be paid out 100% of the community funds.

*Note: If there is a will, language in the will may direct the executor to pay the decedent's debts out of the decedent's "residuary estate." This may be interpreted to require the executor to pay any and all debts for which the deceased spouse had*

*personal liability out of the deceased spouse's separate property and one-half of the community. Absent that language, certain debts should be paid out of both halves of the community property under administration.*

**C. 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 generally entitled to their respective one-half interests in each and every community probate asset. Tex. Prob. Code § 37.

**VII. SURVIVING SPOUSE'S DEBTS**

This outline has focused primarily on the Legislature's statutory design for handling the debts of the spouses during the marriage and the debts of the deceased spouse during the probate administration of the deceased spouse's estate. As noted earlier, the Texas Probate Code does not specifically address the debts of the surviving spouse (defined herein to mean a

debt for which the deceased spouse did not have any personal liability). Many lawyers have assumed that the death of the first spouse should not affect the substantive rights of the spouses' creditors. But, it does! Borrowing a phrase from Professor Paulsen, an unsecured creditor of the surviving spouse may not have any special rights against the deceased spouse's estate. *See* Note I, A, *supra*.

### **A. Secured Debts**

Section 156 of the Texas Probate Code suggests that a creditor of the surviving spouse who has a security interest in former community property which is not subject to administration (i.e., the surviving spouse's special community property) does not have a claim against the deceased spouse's estate, if the deceased spouse did not have personal liability for the debt. The surviving spouse still has personal liability; her nonexempt separate property and undivided one-half interest in the couple's former community property (plus whatever nonexempt property she inherits) can be reached to satisfy the debt. The creditor's security interest in the survivor's former special community property remains attached to the property. However, except to the extent of the security interest, the decedent's property may not be reachable by the surviving spouse's creditors.

### **B. Unsecured Debt**

If the creditor is an unsecured creditor of only the surviving spouse (i.e., the deceased spouse did not have any personal liability), the surviving spouse's nonexempt separate property and one-half interest in the former community property (plus whatever the surviving spouse inherited) remain liable for the debt. However, the statutory framework suggests

that the decedent's separate property and one-half interest in the former community property is not reachable by the creditor unless (and to the extent) such property passes to the surviving spouse by reason of the deceased spouse's death. Other distributees of the deceased spouse's estate appear to acquire their inheritance, free of the surviving spouse's debts.

### **C. The Rationale**

The Texas Family Code's liability rules only apply during the marriage. Once the marriage terminates by reason of the first spouse's death, the rules change. Sometimes the changes work in favor of a creditor. For example, the deceased spouse's contract creditors can reach the decedent's one-half of the surviving spouse's former special community property. During marriage, they could not. Sometimes, it does not; only the decedent's one-half interest in the surviving spouse's former special community is liable for the decedent's tort debts. During marriage, all of the community was liable for either spouse's tortious debts.

The Legislature's failure to expressly address such debts of the surviving spouse implies that the creditors of the surviving spouse do not have claims against the deceased spouse's estate. Such creditors were not creditors of the deceased spouse. The deceased spouse's estate (the decedent's separate property and one-half of the former community property) passes subject to the deceased spouse's debts, not the surviving spouse's debts.

#### D. Summary

Using this rationale, following the death of the first spouse, the proper analysis should begin with the answers to the following questions:

1. Whose debt was it? *The deceased spouse's? The surviving spouse's? Or both spouses'?*
2. Is the debt secured? *Yes or no? If yes, is the property securing the debt subject to administration?*
3. If an unsecured debt was incurred by the deceased spouse, was it a debt for a "necessity"? Or, was the deceased spouse acting as the agent of the surviving spouse?
4. If an unsecured debt was incurred by the surviving spouse, was it a debt for a "necessity"? Or, was the surviving spouse acting as the agent of the deceased spouse?

*Recall, the marital relationship, in and to itself, does not make one spouse the agent of the other spouse.*

#### VIII. CLAIMS FOR REIMBURSEMENT

Reimbursement may make one spouse the other spouse's creditor. Reimbursement between the marital estates usually arises when one spouse's separate property is improved through the expenditure of community funds or community time, talent and labor. Reimbursement may also be applicable if

separate funds are expended to benefit community property. The increased importance of this concept over the last thirty years 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, as well as legislative interference in recent years.

#### A. Application at Death

In *Dakan v. Dakan*, 125 Tex. 305, 83 S.W.2d 620 (1935), the court held that a community claim for reimbursement existed at the owner's death, thereby placing the surviving spouse to an equitable election (i) to accept any benefits conferred in the will and waive the claim, or (ii) to assert the claim and waive any benefits under the will. It would also follow that the claim exists upon the death of the non-owner, thereby possibly imposing a duty on the personal representative to pursue the claim against the surviving owner/spouse.

#### B. 2009 Legislation

In 2009, what had been defined separately as claims for economic contribution and statutory claims for reimbursement were combined as "claims for reimbursement."

#### 1. Reimbursement Defined

A claim for reimbursement includes: (i) payment by one marital estate of an unsecured liability of another marital estate; (ii) inadequate compensation for the time, toil, talent and effort of a spouse by a business entity under the control and direction of that spouse; (iii) what had been considered claims for economic contribution under former § 3.402(a); and (iv) the reduction by the community property estate of an unsecured debt incurred by the

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separate estate of one of the spouses. Tex. Fam. Code § 3.402(a). Economic contributions previously arose in six statutorily defined situations related to use of the 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.

### 2. Equitable Principles

A claim for reimbursement is to be resolved by using equitable principles, including the principle that claims for reimbursement may be offset against each other if the court determines it to be appropriate. Tex. Fam. Code § 3.402(b). However, reimbursement for funds expended by a marital estate for improvements to another marital estate be measured by the enhancement in value to the benefited marital estate. Tex. Fam. Code § 3.402(d).

### 3. Use and Enjoyment

Generally, the use and enjoyment of property is to be offset against a claim for reimbursement for expenditures to benefit a marital estate. However, a party may not claim an offset for use and enjoyment of a primary or secondary residence owned in whole or part by the separate estate against contributions made from the community estate to benefit the separate estate. Tex. Fam. Code § 3.402(c). The party seeking an offset to a claim for reimbursement has the burden of proof with respect to the offset. Tex. Fam. Code § 3.402(e).

### 4. Surviving Spouse's Election

If the owner spouse devises the benefited separate property to the other spouse, the other spouse should not be able to accept the devise and also assert a claim

for reimbursement. The same rationale would suggest that the surviving spouse should not be able to assert the claim if the benefitted property is devised to a bypass or Q-Tip trust for the benefit of the surviving spouse. 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 reimbursement.

### 5. Equitable Claims

Notwithstanding the repeal of Section 3.408, surely the new law does not eliminate from Texas law traditional claims for reimbursement.

### 6. Non-Reimbursable Claims

The statute still describes 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 § 3.409.

### 7. Marital Property Agreement

Marital property agreements executed before or after September 1, 2009, the effective date of the 2009 legislation, which waive or partition reimbursement claims or claims for economic contribution will be effective to waive claims for current claims for reimbursement. Tex. Fam. Code § 3.410.

## C. **Death of Claimant Spouse**

Upon the intestate death of the spouse who has a reimbursement claim against the surviving spouse, the claimant



spouse's claim passes to that deceased spouse's heirs.

1. Testate Situation

If the claimant died testate, the terms of the will may resolve the reimbursement issue. For example, the testator may have expressly waived the claim against the surviving spouse. Such a waiver may be conditioned on the surviving spouse waiving any reimbursement claims against the testator's estate. A specific devise of the benefitted property to the surviving spouse should be presumed to be an implied waiver of the claim against the surviving spouse. The same rationale would suggest that the representative should not be able to pursue the claim against the surviving spouse if the benefitted property passes into a bypass or Q-Tip trust for the benefit of the surviving spouse. It seems unlikely the testator would have devised the testator's benefit separate property or community property to or for the benefit of the surviving spouse if the testator would have wanted the representative to pursue the community or separate claim against the surviving spouse.

2. Duty of Personal Representative

If the claim is a viable one, the personal representative may have a duty to pursue the claim against the owner spouse. The existence of the claim may result in a much larger estate than had been anticipated. The deceased spouse's interest in the claim is included in the deceased spouse's gross estate for estate tax purposes and may cause an immediate liquidity problem.

3. Conflict of Interests

The existence of a viable claim may create a conflict of interest for both the

personal representative and the attorney who are attempting to represent the entire family.

**D. Claimant as the Surviving Spouse**

Upon the death of the owner spouse, the property which is the subject of the claim for reimbursement passes under the owner's will or by intestate succession; however, the claim of the surviving spouse continues to exist.

1. Conflict of Interests

A viable claim can create a conflict of interest (i) between the surviving spouse and the decedent's heirs or devisees, 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. Election

If the owner died testate, the doctrine of 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 received a benefit and suffers a detriment in a will.

3. Other Problems

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

## IX. FRAUD ON THE COMMUNITY

It is not unusual to discover, following the death of the deceased spouse, that the decedent made a nonprobate disposition of community property to a third party or that the surviving spouse had made an inter vivos gift of community property to a third party. The third party may be a child of the couple, a child by a prior marriage, a charity or an elderly parent or a paramour.

The Texas Family Code generally grants to the managing spouse the power, with or without consideration, to transfer to a third party 100% of that spouse's *special community property* without the joinder, the consent or even the knowledge of the other spouse. *Massey v. Massey*, 807 S.W.2d 391 (Tex. App.—Houston [1st Dist] 1991, writ denied). Joint community property is different.

Note: *ERISA regulated retirement plans are treated differently as well. See V and VI, supra.*

### A. Consequences of Joint Management

If the subject of the nonprobate disposition or gift was the couple's joint community property, it is arguable that the purported disposition is void as to the other spouse because the spouse attempting the disposition simply did not have the power to make the disposition without the joinder or consent of the other spouse. Tex. Fam. Code § 3.1002(b). The attempted disposition may even be void as to the donor spouse's one-half interest in the proper. If the transaction is not void or voidable as a matter of law, or if the other spouse previously authorized the donor spouse to generally manage the property and then there was a nonprobate disposition or gift, it would appear that the analysis should be

similar to the one applied to the unilateral transfer of special community property—"fraud on the community analysis." See VIII, B-H, *infra*.

However, the Texas Supreme Court has not yet definitively determined whether one spouse can assign his or her own undivided one-half interest in joint community property to a third party without the joinder of the other spouse. The view more consistent with the overall statutory scheme would void such a unilateral attempt as an attempt to unilaterally partition; partitions require the joinder of both spouses. The courts of appeals are divided. See *Williams v. Portland State Bank*, 514 S.W.2d 124 (Tex. Civ. App.—Beaumont 1974, writ dismissed); *Vallone v. Miller*, 663 S.W.2d 97 (Tex. App.—Houston [14th Dist.] 1983, writ refused n.r.e.); *Dalton v. Don J. Jackson, Inc.*, 691 S.W.2d 765 (Tex. App.—Austin 1985, writ refused n.r.e.).

### B. Fiduciary Obligation

As to the special community property of a spouse, the managing spouse's power is limited by a fiduciary obligation owing to the other spouse due to the existence of the marital relationship. A trust relationship exists between the spouses as to the special community property controlled by each spouse. See *Carnes v. Meador*, 533 S.W.2d 365 (Tex. Civ. App.—Dallas 1975, writ refused n.r.e.). This special relationship has many of the characteristics of a private express trust: (i) identifiable property – a spouse's special community property; (ii) separation of legal and equitable title – the managing spouse has legal title and the equitable title is owned equally by both the spouses; and (iii) fiduciary duty. While not defined by the intent of a settlor, the Texas Trust Code or the common law, and while not the same, nor nearly as extensive, as the duties generally imposed on trustees of

express trusts, the managing spouse's power of management is limited by the duty not to commit "fraud on the community."

### C. The Managing Spouse's Duty

The managing spouse has the duty not to commit a fraud on the community property rights of the other spouse (i.e., not to dispose, transfer or diminish that spouse's special community property in fraud of the other spouse's rights to that property). See *Matter of Marriage of Moore*, 890 S.W.2d 821 (Tex. App.—Amarillo 1994, no writ) and *Jackson v. Smith*, 703 S.W.2d 791 (Tex. App.—Dallas 1985, no writ), where the court refers specifically to the fiduciary relationship that exists between spouses.

### D. Burden of Proof

Because the managing spouse has the power under the Texas Family Code to dispose of that spouse's special community property, the burden is on the other spouse to raise the issue of fraud on the community when the marriage terminates. That spouse may seek to establish that the managing spouse's action with respect to the managing spouse's special community property amounted either to "actual" or "constructive" fraud.

For example, to establish that the managing spouse's gift to a third party amounted to actual fraud, the other spouse must prove that the gift was made with the primary purpose of depriving the other spouse of that asset. Constructive fraud is established where a gift is found to be "unfair" to the other spouse. See *Horlock v. Horlock*, 533 S.W.2d 52 (Tex. Civ. App. — Houston [14th Dist.] 1975, writ dism'd w.o.j.). Texas courts have also set aside a gift as constructively fraudulent if the gift was capricious, excessive or arbitrary. See *Carnes v. Meador*, *supra*, and *St. v. Skipper*,

887 S.W.2d 78 (Tex. App.—Fort Worth 1994, writ denied).

Once the issue of constructive fraud is raised, the cases suggest the burden switches to the managing spouse to prove that the gift was fair to the other spouse. See *Murphy v. Metro. Life Ins. Co.*, 498 S.W.2d 278 (Tex. Civ. App.—Houston [14th District] 1973, writ ref'd n.r.e.), and *Givens v. The Girard Life Ins. Co.*, 480 S.W.2d 421 (Tex. App.—Dallas 1972, writ ref'd n.r.e.). *Jackson v. Smith*, *supra*. Factors to be considered in determining whether there has been a constructive fraud include (i) the size of the gift in relation to the total size of the community estate, (ii) the adequacy of the remaining community assets to support the other spouse, and (iii) the relationship of the managing spouse to the donee. See *Horlock v. Horlock*, *supra*. Another court described the factors to be considered as (i) whether special circumstances justify the gift and (ii) whether the community funds used were reasonable in proportion to the remaining community assets. *Givens*, *supra*. Most of the cases in this area involve excessive or capricious consumption of community assets, or gifts of community assets to third parties as the basis of constructive fraud on the community. See Stewart Gagnon, Kathryn Murphy, Ike Vanden Eykel, *Texas Practice Guide - Family Law*, §§ 16:8–16:95 (West).

### E. Remedies Generally

The managing spouse's abuse of managerial powers of community assets affects not only the equitable division of the remaining community estate upon divorce, but can result in the awarding of a money judgment for damages to the other spouse when the marriage terminates in order to recoup the value of the other spouse's share of the community lost through the managing spouse's wrong doing. See *Mazique v.*

*Mazique*, 742 S.W.2d 805 (Tex. App.—Houston [1st Dist.] 1987, no writ). *Massey v. Massey*, 807 S.W.2d 391 (Tex. App.—Houston [1st Dist.] 1991, writ denied); *Matter of Marriage of Moore*, 890 S.W.2d 821 (Tex. App.—Amarillo 1994, no writ). A judgment for money damages against the transferee may also be possible. See *Madrigal v. Madrigal*, 115 S.W.3d 32, 35 (Tex. App.—San Antonio 2003, no pet.) (citing *Estate of Korzekwa v. Prudential Ins. Co. of Amer.*; 669 S.W.2d 775, 778 (Tex. App.—San Antonio 1984, writ dismissed); *Hartman v. Crain*, 398 S.W.2d 387, 390 (Tex. Civ. App.—Houston 1966, no writ). Courts have also used their equitable powers to impose a constructive trust on community assets given to third parties. See *Carnes v. Meador*, *supra* and *In re Murrell*, 1998 Tex. App. LEXIS 7603 (Tex. App.—Amarillo 1998, no writ) where the court found constructive fraud and explains that the equitable title to the property transferred to a third party was still community property.

#### F. The *Schlueter* Case

In *Schlueter v. Schlueter*, 975 S.W.2d 584 (Tex. 1998), the Texas Supreme Court emphasized that fraud on the community is not a separate tort cause of action, but is a form of fraud cognizable within the equitable division of the community estate. Consequently, punitive damages are not appropriate. According to *Schlueter*, a money judgment for actual damages can be awarded to allow the wronged spouse to recoup the community estate loss due to the other spouse's fraud on the community; the amount of the judgment is specifically referable to the value of the lost community and cannot exceed the total value of the community estate.

Relying on *Schlueter*, the Texas Supreme Court has recently ruled that a wife, whose husband had committed a fraud

on the community prior to their divorce, was not able to hold a lawyer liable for conspiracy with the husband to commit the fraud. The court reaffirmed the *Schlueter* rationale (i.e., there is no independent tort cause of action for wrongful disposition by a spouse), noting that it is hard to see how the community has been damaged if one spouse retains the fruits of the fraud, and finally held that, if the spouse cannot be held liable for the tort and punitive damages, neither can a co-conspirator. *Chu v. Hong*, 249 S.W.3d 441 (Tex. 2008), *rev'g* 185 S.W.3d 507 (Tex. App. – Fort Worth 2005, no pet.). The fraudulent sale was found to be void and the buyers were divested of ownership; interestingly, the lawyer represented the buyer.

Note: In 2011, the Texas Legislature enacted Tex. Fam. Code § 7.009, which purports to codify and clarify the *Schlueter* decision. This statute requires a divorce court to “reconstitute” the community estate by placing a value on the community asset wrongly transferred and adding it back to the value of the existing community estate. It is a divorce concept—not a probate concept.

#### G. Death of a Spouse

In the event the marriage terminates by reason of the death of a spouse, the managing spouse should be liable to the estate of the other spouse, or the estate of the managing spouse should be liable to the other spouse, for any actual damages suffered by the other spouse arising from a fraud on the community. For example, if \$100,000 of community assets were wrongfully transferred by the managing spouse to a third party, the other spouse, or that other spouse's estate, has a claim for money damages in the amount of \$50,000, an amount equal to the other spouse's one-

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half community interest in the \$100,000 wrongfully transferred. If the managing spouse, or the managing spouse's estate, does not have sufficient assets to satisfy the claim for damages, the court may impose a constructive trust on the third party donee in order to retrieve one-half of the community asset that had been wrongfully transferred to the donee. *Carnes v. Meador, supra*. See *Osuna v. Quintana*, 993 S.W.2d 201, 209 (Tex. App.—Corpus Christi 1999, no pet.) discussing the difference in remedies in death and divorce situations.

### 1. The Harper Case

In *Harper v. Harper*, 8 S.W.3d 782 (Tex. App.—Fort Worth 1999, pet. den.), the court cites *Schlueter* for the holding that “. . . fraud on the community exists outside the realm of tort law and cannot be brought as an independent cause of action . . .” before holding that punitive damages are not recoverable. The only damages being sought against the managing spouse in *Harper* were punitive damages since the estate of the other spouse had already received half of the sales proceeds (plus interest) in satisfaction of the other spouse's interest in the property at issue. *Harper* and *Schlueter* do not hold that the other spouse cannot seek actual damages where the managing spouse commits a fraud on the community.

Note: Some have argued that *Harper* is authority for the proposition that “fraud on the community” does not survive the death of a spouse. That is clearly not the holding in *Harper*.

### 2. Examples

- a. Assume that a husband gives his mother his special community car, or a husband

designates his child by a previous marriage as beneficiary of an insurance policy that is the husband's special community property, or a husband deposits special community cash into a bank account payable at his death to his paramour. Upon the husband's death, the car is still owned by the husband's mother and the proceeds of the policy and the funds on deposit belong to the designated third party beneficiary, unless the transfer to the mother, child or paramour is set aside as to the wife's one-half interest because the transfer is found to have been in fraud of the surviving spouse's rights. The court should, however, first attempt to make the wife whole by an award of money damages out of the husband's estate, if fraud on the community is established.

- b. If the wife dies first, any cause of action for fraud on the community belongs to her successor in interest, the personal representative of her estate, or her heirs or devisees. However, the life insurance policy and the bank account, being the husband's special community property, are simply partitioned by reason of the wife's death, as probate assets. The wife's successor may then elect to pursue the fraud claim against the husband concerning the car. Of

course, if the husband is the wife's sole heir or devisee, the claim is extinguished unless the wife's estate is insolvent since the claim is an asset subject to the wife's debts under Tex. Prob. Code § 37.

#### H. *Street v. Skipper*

In *Street v. Skipper*, 887 S.W.2d 78 (Tex. App.—Fort Worth 1995, writ denied) a special community property life insurance policy was payable to the insured spouse's probate estate, and his wife correctly argued that the husband did not have the power to devise by will her one-half of the policy proceeds to his devisees. In effect, the wife was arguing that the proceeds payable to the estate were probate assets, and she was entitled to one-half of the proceeds without needing to prove fraud on the community. In other words, the husband did not have the authority to devise the wife's one-half interest in community property, which is a fundamental concept.

However, the court held that the controlling issue was whether or not the husband had committed fraud on the community. It then considered the fact that the value of the total community estate, including the life insurance policy, was approximately \$4,600,000 and that under the will the wife would retain and/or inherit more than half of that amount by reason of her husband's death. In addition, she received a portion of the husband's separate property, including her homestead rights in his separate property home. The court concluded that a fraud on the community had not occurred. The result may have been correct, but the reasoning was not. While the husband did not have the authority to devise his wife's one-half of the proceeds, perhaps it was her "election" to take under

the will that estopped her from asserting her right to her one-half of the proceeds.

#### 1. Third Party Designation?

Would the result in *Street* be different had the husband designated the third party as the direct beneficiary of the policy rather than designating his estate? Arguably not. Such a change in facts raises the issue of fraud on the community, and assuming the wife still retained or inherited in excess of one-half of the value of the community by reason of her husband's death, the result would depend on the overall "fairness" of the situation. See *Jackson v. Smith*, *supra* and *Redfern v. Ford*, 579 S.W.2d 295 (Tex. Civ. App.—Dallas 1979, writ ref'd n.r.e.). See II, F, 4, *infra*.

#### 2. Tweaking the Facts

Would the result in *Street* be different had the wife not received at least one half of the total community estate and a significant devise of the husband's separate property? For example, assume that the third party had been designated the beneficiary of the community-owned insurance and was also the sole devisee under the husband's will. In other words, the wife retained only her one-half of the community probate assets and her homestead right of occupancy in the husband's separate property home. Obviously, that situation is the classic example of the commission of a fraud on the community.

#### 3. Election?

However, how would the analysis differ had the husband devised to his wife a portion of his half of the community property or some of his separate property, but the value of what was devised to the

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wife was less than the value of her one half of the insurance proceeds payable to a third party? Absent actual fraud, the answer appears to depend in part on the fairness factors to be considered in determining if the insurance designation amounted to a constructive fraud on the community.

The tougher theoretical question may be whether the wife can assert her claim of fraud on the community (or her right to one-half of the proceeds under the partition approach) and still retain the property devised to her in the will. In other words, will she be required to, in effect, “elect against the will” in order to pursue her community interests devised to a third party?

### I. Illusory Transfers

In *Land v. Marshall*, 426 S.W.2d 841 (Tex. 1968), the Texas Supreme Court held that a husband's creation of a revocable trust with his special community property was illusory as to his wife's one-half community interest therein since the husband had, in effect, retained essential control over the trust assets. The key factor was the revocability of the trust. Accordingly, the wife was able to set aside the trust as to her one-half interest upon her husband's death.

*Query: To date, the illusory transfer argument has been applied only to revocable trusts. Would it also apply in theory to any revocable nonprobate disposition (e.g., a POD bank account)?*

### J. Fraud on Creditors

Certain transfers between spouses and transfers to third parties may be set aside by creditors under both Texas and federal law. See the Uniform Fraudulent Transfer Act, Tex. Bus. & Comm. Code §§

24.001-24.013 and the U.S. Bankruptcy Code, 11 U.S.C. § 544(b).

Note: *The definition of creditor includes a spouse who has a claim.*

### K. Federal Preemption

In *Barnett v. Barnett*, 67 S.W.3d 107 (Tex. 2001), the Texas Supreme Court held that a wife's claim for constructive fraud on the community and her corresponding claim for the imposition of a constructive trust following her husband's death were preempted by ERISA. In that case, a husband had designated a third party as the beneficiary of a life insurance policy that was part of an employee benefit plan covered by ERISA.

Although the policy was community property, the wife's claim in *Barnett* was based on Texas law (i.e., “fraud on the community”) that had a connection with an ERISA plan and was, accordingly, preempted. The court explained that the application of Texas community property laws would interfere with the national uniformity of a matter central to ERISA plan administration. Thus, in the absence of actual common law fraud, the court found that Texas' concept of “fraud on the community” had no counterpart in federal common law.