

Fraud on the Community and the Reconstituted Estate

Kathryn J. Murphy
Goranson Bain Ausley, PLLC

I. Introduction

This article discusses fraud on the community (which includes actual fraud, constructive fraud, and waste) and the reconstituted estate.

II. Fraud on the Community

A. Claim for Fraud on the Community

Fraud on the community can be committed through actual fraud or constructive fraud. *Strong v. Strong*, 350 S.W.3d 759, 771 (Tex. App.—Dallas 2011, pet. denied); *Sprick v. Sprick*, 25 S.W.3d 7 (Tex. App.—El Paso, 1999, pet. denied). Some courts have mistakenly equated “fraud on the community” to constructive fraud. *Id.*

B. No Independent Cause of Action for Fraud on the Community

The *Schleuter* court held that because spouses have an adequate remedy for fraud on the community through the “just and right” property division upon divorce, there is no independent tort cause of action between spouses for damages to the community estate. *Schleuter v. Schleuter*, 975 S.W.2d 584 (Tex. 1998).

C. Independent Tort for Actual Fraud Concerning Separate Estate

A spouse can sue the other spouse as an independent cause of action for actual fraud concerning the defrauded spouse’s separate estate. In such a case, punitive damages should be available. *Schleuter v. Schleuter*, 975 S.W.2d 584 (Tex. 1998).

D. Actual Fraud

1. Elements

Actual fraud involves dishonesty of purpose or intent to deceive. *Horlock v. Horlock*, 533 S.W.2d 52 (Tex. App.—Houston [14th Dist.] 1975, writ dismissed); *In re Marriage of DeVine*, 869 S.W.2d 415 (Tex. App.—Amarillo 1993, writ denied).

A spouse commits actual fraud if the following exist:

- a. that spouse transfers community property or expends community funds;
- b. for the primary purpose of depriving the other spouse of the use and enjoyment of the assets involved in the transaction; and
- c. with dishonesty or intent to deceive. Texas Pattern Jury Charges—Family & Probate (2020), PJC 206.2A.

2. Intent to Harm

Actual fraud requires intent to harm by transferring or expending community property to deprive the other spouse of the use and enjoyment of the assets involved in the transaction. *In re Marriage of DeVine*, 869 S.W.2d 415 (Tex. App.—Amarillo 1993, writ denied)(actual fraud found where wife persuaded husband to invest community funds with her paramour without informing him of their true relationship); *Wright v. Wright*, 280 S.W.3d 901 (Tex. App.—Eastland 2009, no pet.)(actual fraud found -- husband drained bank accounts and transferred property to third parties days after wife filed for divorce and without wife’s knowledge or consent); *Logsdon v. Logsdon*, 2015 WL 7690034 (Tex. App.—Fort Worth 2015, no pet.)(mem. op.)(trial court found wife committed actual fraud against the community estate by transferring and expending community funds to benefit herself and her adult son with intentional dishonesty and with the intent to deceive husband).

3. Burden of Proof

The burden of proof for a claim of actual fraud is on the complaining party. *Horlock v. Horlock*, 533 S.W.2d 52 (Tex. App.—Houston [14th Dist.] 1975, writ dismissed).

4. Heightened Culpability

The Texas Supreme Court has suggested that actual fraud involves “heightened culpability” and should yield a more disproportionate split of community property than constructive fraud. *Schleuter v. Schleuter*, 975 S.W.2d 584 (Tex. 1998).

5. Third Party Liability

The Texas Supreme Court has held that a third party cannot be held liable in tort when community property is taken by one of the spouses. *Chu v. Hong*, 249 S.W.3d 441 (Tex. 2008). The Court in *Chu* noted that “in *Schleuter* we did not decide whether torts against the community estate could be alleged against a third-party. As a general matter, they clearly can; if a third party steals community property, surely either spouse or both can seek recovery in tort for it.” Generally, the remedy available is limited to recovery of the fraudulently obtained property or damages limited to the value of the property transferred. *Id.*; *West v. West*, No. 01-11-00051-CV (Tex. App.—Houston [1st Dist.] 2012, no pet.)(mem. op.)(husband and his parents found to have committed fraud when wife was told that she and husband had an ownership interest in property that they made payments towards; trial court judgment against parents in the amount of \$30,000 was affirmed); *Schleuter v. Schleuter*, 975 S.W.2d 584 (Tex. 1998)(affirmed monetary award in divorce action against husband’s father based on transfer of community assets to father immediately prior to divorce).

A spouse who gives away community property to friends or relatives when divorce is imminent has defrauded the community estate. In such cases, a trial court can order the spouse to return the property or take the fraud into account in making a just and right division. *Id.*; *Kite v. King*, 492 S.W.3d 468 (Tex. App.—Amarillo 2016, no pet.)(a third party is not liable in tort when community property is transferred to them by one of the spouses -- the remedy is to seek a reconstituted estate at the time of divorce).

See also *Thomas v. Casale*, 924 S.W.2d 433 (Tex. App.—Fort Worth 1996, writ denied)(third parties are jointly and severally liable for actual fraud along with the fraudulent spouse if they knew about the spouse’s fraudulent intent to injure the other spouse’s rights; *Osuna v. Quintana*, 993 S.W.2d 201, 207-08 (Tex. App.—Corpus Christi 1999, no writ)(joint and several judgment against husband and mistress upheld, which represented total community funds diverted by husband to mistress).

E. Constructive Fraud

1. Constructive Fraud and Breach of Fiduciary Duty

A fiduciary duty exists between a husband and a wife as to the community property controlled by each spouse. *In re Marriage of Moore*, 890 S.W.2d 821 (Tex. App.—Amarillo 1994, no writ); *Sprick v. Sprick*, 25 S.W.3d 7 (Tex. App.—El Paso, 1999, pet. denied). Constructive fraud is based upon the existence of a fiduciary duty requiring utmost good faith. *In re Marriage of DeVine*, 869 S.W.2d 415 (Tex. App.—Amarillo 1993, writ denied).

Constructive fraud claims are also referred to as waste claims. *Puntarelli v. Peterson*, 405 S.W.3d 131 (Tex. App.—Houston [1st Dist.] 2013, no pet.); *Schleuter v. Schleuter*, 975 S.W.2d 584 (Tex. 1998)(waste occurs when a spouse, without the other spouse’s knowledge or consent, wrongfully depletes the marital estate of community assets).

Constructive fraud includes actions of one spouse in unfairly disposing of or encumbering the other spouse’s interest in community property or unfairly incurring community indebtedness without the other spouse’s knowledge or consent. *Massey v. Massey*, 807 SW.2d 391 (Tex. App.—Houston [1st Dist.] 1991), *writ denied*, 867 S.W.2d 766 (Tex. 1993)(per curiam). In the absence of fraud, a spouse has the right to control and dispose of community property subject to his sole management. *Mazique v. Mazique*, 742 S.W.2d 805, 807 (Tex. App.—Houston [1st Dist.] 1987, no writ).

Although the managing spouse need not obtain approval or consent for dispositions made of special community property, the fiduciary relationship between a husband and wife requires that a spouse’s disposition of special community property be “fair” to the other spouse. *Horlock v. Horlock*, 533 S.W.2d 52 (Tex. App.—Houston [14th Dist.] 1975, writ *dism’d*). The managing spouse carries the burden of establishing that the disposition of property was fair. *Id.*

2. Presumption/Burden of Proof

A presumption of constructive fraud arises where one spouse disposes of the other spouse’s one-half interest in community property without the other spouse’s knowledge or consent. *Zieba v. Martin*, 928 S.W.2d 782 (Tex. App.—Houston [14th Dist.] 1996, no writ); *Wheeling v. Wheeling*, 546 S.W.3d 216 (Tex. App.—El Paso 2017, no pet.); *Knight v. Knight*, 301 S.W.3d 723 (Tex. App.—Houston [14th Dist.] 2009, no pet.); *Mazique v. Mazique*, 742 S.W.2d 805, 807 (Tex. App.—Houston [1st Dist.] 1987, no writ).

Once the presumption arises, the burden of proof shifts to the disposing spouse to show fairness in disposing of community assets. *Puntarelli v. Peterson*, 405 S.W.3d 131 (Tex. App.—Houston [1st Dist.] 2013, no pet.); *Wheeling v. Wheeling*, 546 S.W.3d 246 (Tex. App.—El Paso

2017, no pet.); *Knight v. Knight*, 301 S.W.3d 723 (Tex. App.—Houston [14th Dist.] 2009, no pet.); *Bennett v. Bennett*, 2019 WL 1940859 (Tex. App.—Beaumont 2019, no pet. h.); *Walzel v. Walzel*, No. 14-16-00637-CV (Tex. App.—Houston [14th Dist.] 2018)(mem. op.)(husband disposed of community funds without wife’s knowledge creating a presumption of waste – husband then failed to offer evidence establishing the fairness of the transactions).

3. Intent to Deceive Not Required

Unlike actual fraud, constructive fraud does not require the intent to deceive. *Puntarelli v. Peterson*, 405 S.W.3d 131 (Tex. App.—Houston [1st Dist.] 2013, no pet.); *Sprick v. Sprick*, 25 S.W.3d 7 (Tex. App.—El Paso, 1999, pet. denied).

4. Moderate Gifts or Expenditures Not Constructive Fraud

A spouse may make moderate gifts, transfers, or expenditures of community property for just causes to a third party. *In re Marriage of DeVine*, 869 S.W.2d 415 (Tex. App.—Amarillo 1993, writ denied). *Mazique v. Mazique*, 742 S.W.2d 805, 808 (Tex. App.—Houston [1st Dist.] 1987, no writ).

5. Excessive Gifts

A gift, transfer, or expenditure of community property that is capricious, excessive, or arbitrary is unfair to the other spouse. *Osuna v. Quintana*, 993 S.W.2d 201, 207-08 (Tex. App.—Corpus Christi 1999, no writ); *Horlock v. Horlock*, 533 S.W.2d 52 (Tex. App.—Houston [14th Dist.] 1975, writ dism’d); *Mazique v. Mazique*, 742 S.W.2d 805, 808 (Tex. App.—Houston [1st Dist.] 1987, no writ)(husband used community funds to pay expenses for several extramarital affairs that included trips, meals, gifts, and hotels); *Cantu v. Cantu*, No. 14-17-00175-CV (Tex. App.—Houston [14th Dist.] 2018, no pet.)(trial court found that husband committed fraud on the community and gave wife a disproportionate share of the remaining community assets – husband had numerous affairs during the marriage and spent lots of money on paramours).

6. Fairness of Gift, Transfer or Expenditure

A presumption of constructive fraud can be rebutted if the spouse who disposed of the community property shows that the disposal was fair. *Massey v. Massey*, 807 SW.2d 391 (Tex. App.—Houston [1st Dist.] 1991), writ denied, 867 S.W.2d 766 (Tex. 1993)(per curiam); *Wheeling v. Wheeling*, 546 S.W.3d 246 (Tex. App.—El Paso 2017, no pet.); *Wright v. Wright*, 280 S.W.3d 901 (Tex. App.—Eastland 2009, no pet.)(husband did not prove that transfer of community stock to third party was fair).

Factors the court can consider in determining the fairness of a gift, transfer, or expenditure are—

- a. The relationship of the parties involved in the transaction;
- b. The size of the property in relation to the total size of the community estate.
- c. The adequacy of the remaining estate; and
- d. Whether there were any special circumstances tending to justify the gift, transfer, or expenditure. *Wheeling v. Wheeling*, 546 S.W.3d

246 (Tex. App.—El Paso 2017, no pet.); *Puntarelli v. Peterson*, 405 S.W.3d 131 (Tex. App.—Houston [1st Dist.] 2013, no pet.); *Sykes v. Sykes*, No. 14-17-00049-CV (Tex. App.—Houston [14th Dist.] 2018, no pet.)(mem. op.)(husband’s gifts of money to a female and cashing funds out of his 401(k) supported a presumption of fraud on the community – husband did not establish the fairness of the disposition).

7. Gifts or Transfers of Community Property

Constructive fraud can be established by evidence of specific gifts or transfers of community property outside the community estate. *Puntarelli v. Peterson*, 405 S.W.3d 131 (Tex. App.—Houston [1st Dist.] 2013, no pet.); *In re Marriage of Notash*, 118 S.W.2d 805 (Tex. App.—Texarkana 2003, no pet.); *Mazique v. Mazique*, 742 S.W.2d 805, 807 (Tex. App.—Houston [1st Dist.] 1987, no writ); *Loaiza v. Loaiza*, 130 S.W.3d 894 (Tex. App.—Fort Worth 2004, no pet.)(waste found where husband made expenditures out of community funds over \$800,000 to his girlfriend without wife’s knowledge or consent).

8. Missing or Unaccounted for Property

Constructive fraud can be established by evidence that community property is unaccounted for by the spouse who was in control of that property. *Wheeling v. Wheeling*, 546 S.W.3d 246 (Tex. App.—El Paso 2017, no pet.); *Slicker v. Slicker*, 464 S.W.3d 850 (Tex. App.—Dallas 2015, no pet.)(trial court award of judgment for waste and constructive fraud affirmed where husband unable to show where withdrawn funds went); *Dailey v. Dailey*, 2013 WL 105667 (Tex. App.—Fort Worth 2013, no pet. h.)(mem. op.)(husband did not explain \$600,000 withdrawal from community funds); *Miller v. Miller*, No. 14-17-00293-CV (Tex. App.—Houston [14th Dist.] 2018, no pet.)(mem. op.)(husband committed fraud on the community and community estate was reconstituted – husband failed to account for significant distributions that were unaccounted for or were spent for non-community purposes).

In cases of unaccounted for property, it is not necessary to show that community property has been specifically gifted or transferred outside the community estate. All that must be shown is that the community property cannot be accounted for. *Puntarelli v. Peterson*, 405 S.W.3d 131 (Tex. App.—Houston [1st Dist.] 2013, no pet.)(constructive fraud established when, among other things, husband could not account for income).

9. Using Excessive Funds

Evidence of a spouse using excessive funds without the other spouse’s consent supports a waste finding. *Graves v. Tomlinson*, 329 S.W.3d 128 (Tex. App.—Houston [14th Dist.] 2010, pet. denied)(waste found where excessive attorney’s fees were incurred during divorce proceedings).

10. Without Knowledge or Consent

A presumption of constructive arises when a claimant spouse shows that the other spouse has disposed of community property without his or her knowledge or consent. *Wheeling v.*

Wheeling, 546 S.W.3d 216 (Tex. App.—El Paso 2017, no pet.); *Puntarelli v. Peterson*, 405 S.W.3d 131 (Tex. App.—Houston [1st Dist.] 2013, no pet.); *Slicker v. Slicker*, 464 S.W.3d 850 (Tex. App.—Dallas 2015, no pet.)(wife testified she was unaware of husband’s large withdrawals of community funds, and husband did not present evidence showing otherwise); *Akukoro v. Akukoro*, WL 6729661 (Tex. App.—Houston [1st Dist.] 2013, no pet.)(mem. op.)(husband had no knowledge that wife disposed of community funds until trial); *Everitt v. Everitt*, No. 01-11-00031-CV (Tex. App.—Houston [1st Dist.] 2012, no pet.)(mem. op.)(no evidence that wife consented to using community funds to establish college savings accounts); *Marshall v. Marshall*, 735 S.W.2d 587 (Tex. App.—Dallas 1987, writ ref’d n.r.e.)(wife’s claim of constructive fraud for husband’s gifts to his children from a prior marriage was denied where gifts were equal to 11 percent of the husband’s total earnings during their brief marriage, and where wife was advised of the gifts -- although wife did not actively consent to the gifts, she raised no objection to the gifts at the time they were made).

There is no requirement of diligence on the non-managing spouse, particularly when a relationship of trust and confidence exists between spouses as to that portion of the community property controlled by the managing spouse. *Miller v. Miller*, No. 14-17-00293-CV (Tex. App.—Houston [14th Dist.] 2018, no pet.)(mem. op.)(constructive fraud can still be found when a spouse is uninformed by personal choice in the matters of the community estate). For the presumption of constructive fraud to arise, one spouse need only dispose of the other spouse’s interest in community property without the other’s knowledge or consent. *Everitt v. Everitt*, No. 01-11-00031-CV (Tex. App.—Houston [1st Dist.] 2012, no pet.)(mem. op.). The presumption may arise even when the other spouse has knowledge of the disposition, so long as he or she did not also consent to the disposition. *Id.*

11. Investment Losses

Spending money or losing money on a business venture or investments is not considered fraud or waste. *Connell v. Connell*, 889 S.W.2d 534, 544 (Tex. App.—San Antonio 1994, writ denied); *Andrews v. Andrews*, 677 S.W.2d 171 (Tex. App.—Austin 1984, no writ)(a spouse’s good faith, but unwise, investment of community funds resulting in losses to the community estate does not justify an unequal division of the remaining community estate).

12. Investment Decisions

The “community opportunity doctrine” discussed in *Sprick v. Sprick*, 25 S.W.3d 7 (Tex. App.—El Paso, 1999, pet. denied) provides that a spouse has an obligation to maximize the community estate by taking advantage of an opportunity to invest in a lucrative venture using community, rather than separate, funds. The “community jeopardy doctrine provides that a spouse has an obligation to protect the community estate from risky pursuits by investing separate, rather than community, funds. The Court stated that “whether an investment is potentially lucrative or risky is easier to discern in hindsight and is ordinarily fact specific.”

If a spouse has an opportunity to make an investment decision that will deliver a financial result, that spouse has a fiduciary duty to make the investment on behalf of the community estate if funds exist. *Massey v. Massey*, 807 SW.2d 391 (Tex. App.—Houston [1st Dist.] 1991), *writ denied*, 867 S.W.2d 766 (Tex. 1993)(per curiam)(husband’s investments were constructive fraud).

13. Property Must No Longer Be Part of Community Estate

When a claim for constructive fraud is based on a gift or transfer of community property, the disposed-of property must no longer be a part of the community estate. *Everitt v. Everitt*, No. 01-11-00031-CV (Tex. App.—Houston [1st Dist.] 2012, no pet.)(mem. op.)(husband's nonconsensual transfer of community funds to purchase condo was excluded from constructive fraud claim because condo was a community asset subject to the court's division); *White v. White*, No. 02-07-159-CV (Tex. App.—Fort Worth 2008, no pet.)(mem. op.)(wife's nonconsensual transfer of community funds into new account that only she could access did not support claim for constructive fraud because funds were still available and subject to court's division).

14. Fiduciary Duty When Spouses are Represented by Counsel

Courts have recognized fraud on the community when the wrongful disposition of community property occurred during the divorce. *Everitt v. Everitt*, No. 01-11-00031-CV (Tex. App.—Houston [1st Dist.] 2012, no pet.)(mem. op.)(affirming trial court's finding that husband committed constructive fraud by spending \$249,970 of community property during divorce); *Hancock v. Hancock*, No. 2-06-376-CV, WL 2930586 (Tex. App.—Fort Worth, 2008, no pet.)(mem. op.)(affirming trial court's finding that husband committed fraud on the community by "improperly disposing of certain community property during the pendency of the divorce").

A claim for fraud on the community is not barred as a matter of law if the wrongful disposition of community property occurs during the divorce proceedings. *Miller v. Miller*, No. 14-17-00293-CV (Tex. App.—Houston [14th Dist.] 2018, no pet.)(mem. op.). Such a conclusion would deprive a wronged spouse of the constructive fraud remedy at a time when that spouse's community property interest may be most vulnerable to wrongdoing. *Id.*

15. Change of Life Insurance Beneficiaries

A spouse's unilateral change of the beneficiary on a life insurance policy can be considered constructive fraud. *Givens v. Gerard Life Ins. Co. of America*, 480 S.W.2d 421, 427 (Tex. App.—Dallas 1972, writ ref'd n.r.e.)(husband replacing wife as beneficiary of life insurance policy with his paramour was constructive fraud); *Murphy v. Metropolitan Life Ins. Co.*, 498 S.W.2d 278 (Tex. Civ. App.—Houston [14th Dist.] 1973, writ ref'd n.r.e.)(husband's change in beneficiary designation to his mother constituted constructive fraud).

However, in *Redfearn v. Ford*, 579 S.W.2d 295 (Tex. Civ. App.—Dallas 1979, writ ref'd n.r.e.), when the husband changed the beneficiary designation on a life insurance policy from his wife to their son, the court held the transaction was not unfair to the wife because it diminished her obligation to provide support for the minor child and it was not an unreasonable, excessive or arbitrary transfer); see also *Korzekwa v. Prudential Ins. Co. of America*, 669 S.W.2d 775 (Tex. App.—San Antonio 1984, writ dism'd)(husband changed beneficiary designation of life insurance policy from his wife to his daughter during divorce action in violation of temporary restraining order -- court held the change was not void because the defrauded spouse could be reimbursed from other assets in the estate).

G. Reconstituted Estate for Fraud on the Community

In 2011, the Texas Legislature codified and further clarified the Texas Supreme Court decision in *Schlueter v. Schlueter*, 975 S.W.2d 584 (Tex. 1998), setting forth statutory remedies for actual or constructive fraud on the community estate. *Tex. Fam. Code 7.009*.

This statute requires the court to reconstitute the community estate by valuing the depletion of the community estate and adding the missing value back to the community estate in order to reconstitute what should be the actual, existing value of the estate absent the fraud. *TFC 7.009*. Once the court has determined the reconstituted community estate, the court is given discretion to render a just and right division of the reconstituted value. This may include the award of a share of the remaining estate to the injured spouse, a money judgment, or both. *Tex. Fam. Code 7.009(c); Puntarelli v. Peterson*, 405 S.W.3d 131 (Tex. App.–Houston [1st Dist.] 2013, no pet.).

1. Reconstituted Estate Defined

A reconstituted estate means the total value of the community estate that would exist if an **actual or constructive fraud on the community** had not occurred. *Tex. Fam. Code 7.009(a)*.

2. Remedy for Fraud

If it is determined that a spouse has committed **actual or constructive fraud on the community**, the court shall:

- a. calculate the value by which the community estate was depleted as a result of the fraud on the community and calculate the amount of the reconstituted estate; and
- b. divide the value of the reconstituted estate between the parties in a manner the court deems just and right. *Tex. Fam. Code 7.009(b)*.

3. Just and Right Division of Reconstituted Estate

In making a just and right division of the reconstituted estate under Texas Family Code 7.001, the court may grant any legal or equitable relief necessary to accomplish a just and right division, including:

- a. awarding to the wronged spouse an appropriate share of the community estate remaining after the actual or constructive fraud on the community;
- b. awarding a money judgment in favor of the wronged spouse against the spouse who committed the actual or constructive fraud on the community; or
- c. awarding to the wronged spouse both a money judgement and an appropriate share of the community estate. *Tex. Fam. Code 7.009(c)*.

The just and right division of a reconstituted estate does not have to be equal. *Logsdon v. Logsdon*, 2015 WL 7690034 (Tex. App.—Fort Worth 2015, no pet.)(mem. op.); *Miller v. Miller*, No. 14-17-00293-CV (Tex. App.—Houston [14th Dist.] 2018, no pet.)(mem. op.).

4. Pleadings

A request for a reconstituted estate must be pled to preserve the issue for appeal. *Ford v. Ford*, 435 S.W.3d 347 (Tex. App. – Texarkana 2014, no pet.)(a party relying on Section 7.009 must request that the trial court reconstitute the community estate in order to complain about the trial court’s failure to do so on appeal); *Alfayoumi v. Alzoubi*, No. 13-15-00094-CV (Tex. App.—Corpus Christi 2017, no pet.)(mem. op.)(wife never requested that the community estate be reconstituted pursuant to Section 7.009, either in her pleadings or in her argument to the trial court at the time of trial).

III. Fraud Against a Spouse’s Separate Property

A. Independent Tort Cause of Action to Injury to Separate Estate

Section 7.009 of the Texas Family Code only relates to fraud on the community. There is an independent cause of action for a tortious wrong by a spouse causing personal injury to the other spouse. A spouse may also sue the other spouse for tortious injury to the spouse’s separate estate. *Schleuter v. Schleuter*, 975 S.W.2d 584 (Tex. 1998); *Chu v. Hong*, 249 S.W.3d 441 (Tex. 2008).

IV. Conclusion

Hopefully this article will be a good resource for family law practitioners when dealing with waste, fraud on the community matters and the reconstituted estate. These topics arise frequently in our family law cases, and it is imperative to have a thorough understanding of the law in these areas.