CHARACTER OF DEBTS

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CHAPTER 23

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EDUCATION
J.D., Texas Tech University School of Law, 1999
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EMPLOYMENT
Law Office of Gary L. Nickelson, 2008-present
Partner with Shannon, Gracey, Ratliff & Miller, L.L.P., 2005-2007
Associate with Shannon, Gracey, Ratliff & Miller, L.L.P., 2001-2004
Staff Attorney to Justice David Chew of the El Paso Court of Appeals, 2000
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OFFICES HELD
Vice Chair, Family Law Council, State Bar of Texas Family Law Section 2017-2018
Treasurer, Family Law Council, State Bar of Texas Family Law Section 2016-2017
Secretary, Family Law Council, State Bar of Texas Family Law Section 2015-2016
Member, Family Law Council, State Bar of Texas Family Law Section 2010-2015
Member of the District Seven Grievance Committee 2013-present
Chair of District Seven Grievance Committee 2017-present
Secretary, Eldon B. Mahon Inn of Court, 2012-2013
Director, Tarrant County Bar Association Board of Directors, 2008-2009
Chair of the Tarrant County Bar Association Appellate Section, 2008-2009

HONORS RECEIVED
Board Certified in Civil Appellate Law, 2006-present
Received the SBOT Family Law Section's Dan R. Price Award in 2013
Received the "Joseph W. McKnight Best Family Law CLE Article Award" in 2015 and 2011
Super Lawyer, Texas Monthly Magazine 2014-present
Rising Star, Texas Monthly Magazine 2004-2013
Top Attorney, Fort Worth Magazine, 2007-present

CLE ACTIVITIES
- Co-Author and Presenter of *Wildlings and Other Things Beyond the Wall—The Impact of Character Beyond Dividing the Community Estate*, New Frontiers in Marital Property Law, October 2017, Las Vegas.
- Author and Presenter of *Appellate Issues Affecting Your Family Law Practice*, Advanced Family Law Course, August 2017, San Antonio.
- Course Director, Marriage Dissolution, April 2017, Austin.
- Co-Author and Presenter of *Technology Case Law Update*, Family Law & Technology, December 2016, Austin.
- Co-Course Director, Advanced Family Law Course, August 2016, San Antonio.
- Author and Presenter of *Procedural Tricks and Traps*, Marriage Dissolution, April 2016, Galveston.
- Author and Presenter of *Findings of Fact and Conclusions of Law, What You're Supposed to Write and How it Will Help You*, Advanced Family Law Drafting Course, December 2015, Dallas.
- Author and Presenter of *Who Made This Mess? The Messy Process of Enforcing the Property Division*, New Frontiers in Marital Property Law, October 2015, Denver.
- Author and Presenter of *Jurisdictional Issues*, Advanced Family Law Course, August 2015, San Antonio.
- Author and Presenter of *Evidentiary Predicates*, Marriage Dissolution Course, April 2015, Dallas.

- Co-Author and Co-Presenter of *I love You, You're Perfect, Now Change: PDF Document Management—How to Create, Save, e-File, Markup and Collaborate with Clients and Opposing Counsel from Within the Software*, Family Law Technology 360, December 2014, Austin.
- Author and Presenter of *Recovering Attorney's Fee's*, Advanced Family Law Course, August 2014, San Antonio.
- Co-Author and Co-Presenter of *Post-Trial/Appeal*, Advanced Family Law Course, August 2014, San Antonio.
- Co-Author and Co-Presenter of *Appellate Concerns Before, During, and After Trial*, Advanced Family Law Course, August 2014, San Antonio.
- Author and Presenter of *Pleadings, Motions, and Orders, Relating to Summary, Declaratory, and Default Judgments*, Advanced Family Law Drafting Course, December 2013, Dallas.
- Author and Presenter of *Post-Trial Motions*, Advanced Family Law Course, August 2013, San Antonio.
- Co-Author and Presenter of *Predicates*, Marriage Dissolution Course, April 2013, Houston.
- Co-Author and Co-Presenter of *Dealing with Foreign Jurisdictional Property Issues*, New Frontiers in Marital Property Law, October 2012, New Orleans.
- Co-Author and Co-Presenter of *Appellate Practice—From Every Angle*, Advanced Family Law Course, August 2012, Houston.
- Co-Author and Presenter of *Electronic Discovery—How to Get It*, Marriage Dissolution Course, April 2012, Dallas.
- Author and Presenter of *Post-Trial Drafting Issues*, Advanced Drafting Course, December 2011, Dallas.
- Author and Presenter of *Trying a Case with Appeal in Mind*, Advanced Family Law Course, August 2011, San Antonio.
- Co-Author and Co-Presenter of *Appellate Practice—From Every Angle*, Advanced Family Law Course, August 2011, San Antonio.
- Author and Presenter of *Running a Law Office for Fun And Profit*, Soaking Up Some CLE Seminar, 2011, South Padre.
- Author and Presenter of *Appellate CYA*, Marriage Dissolution Course, April 2011, Austin.
- Author and Presenter of *The Basics: Procedural Concerns*, Parent-Child Relationships Seminar, UT CLE, January 2011, Houston.
- Author and Co-Presenter of *Strategies for Proving Best Interest*, Parent-Child Relationships Seminar, UT CLE, January 2011, Houston.
- Co-Author and Presenter of *Using Summary Judgment Procedure in Family Law Cases*, Advanced Family Law Drafting Course, December 2010, Houston.
- Co-Author and Co-Presenter of *Appellate Practice from Every Angle*, Advanced Family Law Course, August 2010, San Antonio.
- Co-Author and Presenter of *Proving Separate Property: An Argument for More Use of Summary Judgment Practice in Family Law Cases*, Advanced Family Law Course, August 2010.
- Author, *Impacts at Trial: Saving Your Trial from Mistakes*, 10th Annual Family Law on the Front Lines, UT CLE, July 2010, San Antonio.
- Author *of Finalizing the Deal: Rule 11 Agreements, Mediated Settlement Agreements, and Why Its So Important to Get Orders Timely Signed*, Marriage Dissolution Course, April 2010, San Antonio.
- Co-Author and Presenter of *Preservation of Error (Including Making and Meeting Objections)*, 2009 Trial of Breach of Fiduciary Duty Litigation Cases, Fredericksburg, Texas.
- Author and Presenter of *Equitable Remedies: Getting Out of Traps, Messes, and Other Problems to which You or Your Client May Have Unintentionally Agreed*, Advanced Family Law Course, August 2009.
- Course Director for the 2009 Boot Camp prior to the State Bar of Texas Advanced Family Law Course.
- Author and Presenter of, *Appealing Your Family Law Case*, 23rd Annual Family Law Conference, South Texas College of Law, March 2009, Houston.
- Course Director of Family Law Essentials Seminar, October 2008, San Angelo.
- Co-Author of *Professionalism*, August 2008, Advanced Family Law Course, San Antonio.
- Author of *Maintaining the Chain of Electronic Evidence and Spoliation of Electronic Evidence*, Advanced Family Law Course, August 2008.
- Author and Presenter of *Brief Writing that Appeals to Your Audience*, Marriage Dissolution Course, April 2008.
- Course Director for 2008 Brown Bag Seminar for Tarrant County Bar Association titled *"When Reasonable Minds Cannot Disagree: Summary Judgment Practice in Texas."*
- Co-Author and Presenter of *Extraordinary Writs: When Ordinary Relief Just Won't Do* Marriage Dissolution Course, April 2007, El Paso.

- Co-Author of *Appellate Advocacy: From the Judge's Perspective*; Advanced Family Law Course, August 2005.
- Co-Author and Presenter of *Like Skeet and Sporting Clay: Direct and Collateral Attacks on Judgments*, Advanced Family Law Course, August 2005.
- Co-Author of *Preservation of Error for Discovery Issues*, 2005 Brown Bag Seminar for Tarrant County Bar Association, Appellate Section
- Co-Author of *Appellate Advocate - Substantive Court of Appeals Update*, for The Appellate Advocate, 2001-2005.
- Author of *Relief is Just an Appeal Away: Drafting With Appeal*, Advanced Family Law Course, August 2003.
- Author of *Puttin' on the Writs: Mandamus, Prohibition and Habeas Corpus,* Advanced Family Law Course, August 2002.

REPORTED CASES

Litman v. Litman, 402 S.W.3d 280 (Tex.App.—Dallas 2013, pet. denied).

In re C.F.M., 360 S.W.3d 654 (Tex.App.-Dallas, 2012, no pet.).

In re McCray, 324 S.W.3d 685 (Tex.App.—Dallas 2010, orig. proceeding).

Johnson v. State Farm Lloyds, 204 S.W.3d 897 (Tex.App.--Dallas 2006), *aff'd*, 290 S.W.3d 886 (Tex. 2009).

In re Vesta Ins. Group, Inc., 192 S.W.3d 759 (Tex. 2006).

Etheredge v. Hidden Valley Airpark Ass'n, 169 S.W.3d 378 (Tex.App.—Fort Worth 2005, pet. denied).

Citizens Nat'l Bank v. Allen Rae Investments, Inc., 142 S.W.3d 459 (Tex.App.—Fort Worth 2004, no pet.).

Loaiza v. Loaiza, 130 S.W.3d 894 (Tex.App.—Fort Worth 2004, no pet.).

Boyd v. Boyd, 131 S.W.3d 605 (Tex.App.—Fort Worth 2004, no pet.).

U.S. Restaurant Properties Operating L.P. v. Motel Enterp. Inc., 104 S.W.3d 284 (Tex.App.—Beaumont 2003, pet. denied).

Old American Cty. Mut. Fire Ins. Co. v. Michael D. Renfrow, et al, 90 S.W.3d 810 (Tex.App.—Fort Worth 2002), *rev'd by*, 130 S.W.3d 70 (Tex. 2004).

UNREPORTED CASES

In re Darren Keith Reed, et al, 02-18-00088-CV (Fort Worth, April 26, 2018, orig. proceeding).

In re C.F.M. and B.C.M., 05-16-00285-CV (Tex.App.—Dallas, April 9, 2018, n.p.h.).

In re Farahmand, 05-15-00861-CV, 2015 WL 5099468 (Tex.App.--Dallas 2015, orig. proceeding).

In re A.K., 02-14-00344-CV, 2014 WL 7272544 (Tex.App.—Fort Worth 2014, orig. proceeding).

In re Casanova, 05-14-01166-CV, 2014 WL 6486127, (Tex.App.--Dallas 2014, orig. proceeding).

In re D.A., 02-14-00198-CV, 2014 WL 3953645 (Tex.App.—Fort Worth 2014, orig. proceeding).

Tome v. Tome, 02-14-00037-CV, 2014 WL 3953638 (Tex.App.—Fort Worth 2014, orig. proceeding).

In re Cole, 03-14-00458-CV, 2014 WL 3893055 (Tex.App.--Austin 2014, orig. proceeding).

In re Alvarez-Rivas, 02-14-00055-CV, 2014 WL 775402 (Tex.App.—Fort Worth 2014, orig. proceeding).

Clack v. Wollschlager, 2014 WL 2109384 (Tex.App.--Eastland 2014, pet. denied).

In re McCray, 2013 WL 5969581 (Tex.App.--Dallas 2013, orig. proceeding).

In re James M. Fisher II, 2013 WL 5299178 (Tex.App.—Dallas 2013, orig. proceeding).

In re A.P.M., 2012 WL 2088007 (Tex.App.--Dallas 2012, no pet.).

Prentiss v. Prentiss, 2012 WL 858592, Tex.App.-Fort Worth 2012, no pet.).

In re McCray, 2011 WL 6152191 (Tex.App.--Dallas 2011, orig. proceeding).

In re Pemmaraju, 2011 WL 1601234 (Tex.App.-Fort Worth 2011, orig. proceeding).

Game Systems, Inc. v. Forbes Hutton Leasing, Inc., 2011 WL 2119672 (Tex. App. -- Fort Worth 2011, no pet.).

Betti v. Betti, 2010 WL 3788056 (Tex.App.--Dallas 2010, no pet.).

Holloway v. Land, 2010 WL 2555238 Tex.App.-Fort Worth 2010, no pet).

Barnard v. Western Strategic Advisors, LLC, 2008 WL 281549 (Tex.App.-Fort Worth 2008, no pet.).

In re Desa Heating, L.L.C., 2006 WL 1713489 (Tex.App.-Fort Worth 2006, orig. proceeding).

In re Richardson, 2006 WL 1494638 (Tex.App.--Fort Worth 2006, orig. proceeding).

A-1 Systems, Inc. v. Seay, 2002 WL 32341843 (Tex. App.--Eastland 2002, pet. denied).

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Naperville Community High School - 1968
University of Texas at Austin - 1972 B.A.
South Texas College of Law - 1982 J.D.

Professional Awards/Honors
Selected as "Lawyer of the Year" by *Best Lawyers in America*, 2010
Selected as "Collaborative Law Lawyer of the Year" by *Best Lawyers in America*, 2014
Recipient of 1995 Annual David Gibson Award for Professionalism and Excellence in the Practice of Family Law. Presented by the Gulf Coast Family Law Specialists
Recipient of 2008 Houston Bar Association, Family Law Section, Mentor Award
Selected as a "Super Lawyer" by Texas Monthly Magazine each year since inception of award in 2003
Listed in "Best Lawyers in America", from 1999-2010 Edition
Selected as "Top 50 Women Attorneys in Texas", 2007 - 2014
Selected as "Top 100 Houston Region Attorneys", 2007 - 2014
Assistant Course Director, Advanced Family Law Course, State Bar of Texas, 1995
Assistant Course Director, Annual Trial Institute, Texas Academy of Family Law Specialists, 1997
Course Director and Program Chair, New Frontiers In Marital Property Law, 2000
Course Director, Advanced Family Law Course, State Bar of Texas, 2004

Professional Organizations:
Chair, Texas Family Law Foundation (2008-2010)
Member, Legislative Committee, Family Law Section, State Bar of Texas
Family Law Council, State Bar of Texas (1994-2004), Secretary (1998-1999), Treasurer (1999-2000), Vice Chair (2000-2001), Chair Elect (2001-2002), Chair (2002-2003)
Family Law Section, Houston Bar Association - Director (1989-1990, 1995-1996), Secretary (1991-1993), Chair (1994-1995)
State Bar of Texas, District 4-F Grievance Committee (6/91-6/93)
Supreme Court Child Support Guidelines Committee (1988-1989; 1992-1993, 1994-1995, 1995-1996)
Gulf Coast Family Law Specialists, President (1998-1999)
Texas Academy Family Law Specialists, Director (1992-1993, 1996-1997),
Fellow, State Bar Foundation
Revision Committee, State Bar of Texas Family Law Practice Manual, (1990-1998), Chair (1996-1998)
Member, College of the State Bar of Texas
Member, American Bar Association
Member, American Academy of Matrimonial Lawyers
Member, International Academy of Matrimonial Lawyers
Chair of State Bar of Texas, Pattern Jury Charge Committee, Family Law (2007, 2008)
Member, Supreme Court Child Support and Visitation Guidelines Committee
Member Supreme Court Advisory Committee (2000-2003) Ex Officio

Area of Practice:
Family Law
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Mediator, Certified by A. A. White Dispute Resolution Institute
Collaborative Law Institute of Texas, training completed February, 2003

Speaking Engagements:
Marriage Dissolution Institute; State Bar of Texas, (1989-1990, 1992-1994, 1996-1997, 2000, 2004, 2009, 2011, 2012)
Advanced Family Law Course; State Bar of Texas, (1987-2013, 2015-2016)
General Practice Institute; University of Houston Law Center, (1990-1993, 1996)
Family Law for the General Practitioner and Legal Assistant; South Texas College of Law, (1991-1999)
HBA Family Law Section and Houston Chapter TSCPA - Personal Financial Seminar, (1991)
HBA Family Law Section and Houston Chapter TSCPA; Divorce Litigation Seminar, (1991)
Family Law Institute; University of Houston Law Center, (1992)
Advanced Family Drafting Course; State Bar of Texas, (1995, 2008)
Annual Trial Institute; Texas Academy of Family Law Specialists, (1996, 1998, 1999)
Houston Bar Association - Family Law: A Team Approach, (1988)
Texas Academy of Family Law Specialists - Annual Trial Institute, (1996)
Texas Marital Property Institute; University of Texas School of Law, (1997)
Legal Assistant Division; Advanced Family Law Seminar; State Bar of Texas, (1998)
Texas Marital Property Institute; University of Texas Law School; (1997, 1998)
Winning Techniques in Family Law Litigation; State Bar of Texas; (1998)
Annual Family Law Institute; Houston Bar Association; (1999-2000, 2009)
Advanced Drafting: Estate Planning and Probate Court, (1999)
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American Academy of Matrimonial Lawyers, (2000, 2007)
Houston Volunteer Lawyers Program; Family Law Seminar, (1999, 2000, 2003)
Legal Assistant University; State Bar of Texas, (2002)
Houston Bar Association, 2005 Experts Institute, (2005)
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CHARACTER OF DEBTS

I. INTRODUCTION

The law regarding characterization is well understood by family lawyers when it comes to *marital property*. However, the relationship this body of law has with liabilities incurred by spouses before and during marriage is far less understood. This lack of understanding is the result of several factors, including: (1) most people are more interested in understanding the law regulating the character of property than they are debts—since everyone wants property and no one wants debts upon dissolution of marriage; (2) the determination of marital liabilities involves other principles of law, outside the constitutional and statutory laws regarding characterization of property, with which family lawyers are more used to dealing; and (3) several changes in law have been enacted, without much fanfare over the years, leaving many practitioners and courts in the dark about the controlling law regarding marital liabilities. This paper focuses on the liabilities of spouses and their property and it examines whether these liabilities have a character under the Constitution and statutory laws of the State of Texas. While this topic is far from fascinating – it is imminently practical. Understanding the law and concepts laid out in this paper are essential to the successful conclusion of: (1) divorce and annulment proceedings; (2) probate proceedings; (3) bankruptcy proceedings; (4) the protection of your client from his or her spouse's creditors before or after the dissolution of marriage; and (5) drafting pre or post marital agreements that limit your client's potential liability for his or her spouse's liabilities.

II. ACKNOWLEDGEMENT

This paper is the combined work product of Chris Nickelson and Joan F. Jenkins. The authors would like to thank Professor Joseph W. McKnight, Professor Tom Featherston, and Professor James W. Paulsen, for their contributions to family law and their many papers, cited in this paper, regarding marital property and liabilities. The author has found Professor Paulsen's paper on unsecured creditor's rights post-divorce and Professor Featherston's paper on marital liabilities and the myth of community debt to be particularly helpful. *See* James W. Paulsen, The Unsecured Texas Creditor's Post-Divorce Claim to Former Community Property, 63 Baylor L. Rev. 781, 782 (2011); Tom Featherston and Allison Dickson, Marital Property Liabilities Dispelling the Myth of Community Debt, Texas Bar Journal (January 2010). A bibliography is attached to this paper with more articles discussing these topics.

III. TEXAS MARITAL PROPERTY—A QUICK RECAP

Before discussing liabilities, it is helpful to have a short recap of Texas' law on marital property. The Texas Constitution lays the foundation for Texans' marital property rights and puts certain issues, such as the core definition of separate property, beyond the reach of the legislature. It states:

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

See Tex. Const. art. XVI, §15.

Property owned before marriage or acquired after marriage by gift, devise or descent, is separate. *See Id*. By implication, everything else is community property. *See, e.g., Arnold v. Leonard*, 114 Tex. 535, 540, 273 S.W. 799, 801 (Tex. 1925) ("[i]f the method [of acquisition] be by gift, devise, or descent to the wife, then the Constitution makes

the property belong to the wife's separate estate. If the method of acquiring during marriage be different, then the property falls without the class of separate estate of the wife, as fixed by the Constitution.").

As a general rule, the Texas Supreme Court has attempted to defend the constitutionally defined categories of separate property from any attempt by the legislature to expand or diminish them. *Arnold,* 273 S.W. at 802 (discussing the rule of implied exclusion, used when interpreting constitutions and statutes, and stating "Hence, when the Constitution says that as to property, not owned or claimed by the wife at marriage, it becomes her separate property when acquired in one of three specified modes, the Legislature is prohibited from saying that property acquired after marriage in some other mode may also become the wife's separate property.").

However, judicial decisions have further refined and given substance to the basic definition of separate property. For example, income from separate property becomes community property. *See, e.g., De Blane v. Hugh Lynch & Co.*, 23 Tex. 25, 29 (1859)("The law, therefore, conclusively presumes that whatever is acquired, except by gift, devise or descent, or by the exchange of one kind of property for another kind, is acquired by their mutual industry. If a crop is made by the labor of the wife's slaves on the wife's land, it is community property, because the law presumes that the husband's skill or care contributed to its production; or, that he, in some other way, contributed to the common acquisitions."). Likewise, "mutations" or changes in the form of separate property (i.e., an exchange of property for some other property) retains the original separate-property status. *See, e.g., Dixon v. Sanderson*, 10 S.W. 535, 536 (Tex. 1888) (stating that "[p]roperty purchased with money, the separate property of husband or wife, or taken in exchange for the separate property of either, becomes the separate property of the person whose money purchases or whose property is given in exchange...."); *Arnold*, 273 S.W. at 803 (stating that "property remains separate through all mutations and changes"). Only on rare occasion has the Texas Supreme Court had to ignore the rule of implied exclusion and go outside the constitution to determine that a class of property was separate. *See e.g., Graham v. Franco*, 488 S.W.2d 390 (Tex. 1972)(holding that recoveries for personal injury incurred during marriage are separate property since personal injuries are personal to the person regardless of the constitution's more limited definition of separate property).

Before leaving the topic of marital property characterization, there are several threshold points that need to be made before moving on to the topic of marital liabilities—points that are always assumed by family lawyers but probably never discussed often enough.

First, the Texas Constitution speaks in terms of "property" when it discusses characterization. It does not speak in terms of "estates," "debts," or "liabilities," terms which family and probate lawyers discuss often in cases dealing with marital dissolution. Simply put, the concept of characterization laid out in the Texas Constitution relates to "property," not "liability." The only whiff of terms like "debt" or "liability" is found in the clause which references "creditors" and states "provided that person about to marry and spouses, without the intention to defraud creditors, may by written instrument from time to time partition between themselves all or part of their property . . .." *See* Tex. Const. art. XVI, §15. More will be said about this provision later in this paper, but for the moment it is important to note that the concept of characterization is focused on property, not debt or liability.

Second, the term "property" has been interpreted so that it extends to every species of valuable right and interest. *Womack v. Womack*, 141 Tex. 299, 172 S.W.2d 307, 308 (1943); Ocie Speer, Law of Marital Rights in Texas 436 (1929); 1 Edwin S. Oakes, Speer's Marital Rights in Texas 508 (4th ed. 1961). In *Graham*, the Texas Supreme Court stated "[i]n using the word 'property,' the framers of the constitution apparently had in mind property which could be given, bought and sold, and passed by will or by inheritance." *Id.*, 488 S.W.2d at 395. The foregoing definition surely includes debts which are owed to persons about to marry and spouses, but what about debts owed by persons about to marry or spouses to other people? Are such things "property" within the meaning of the Texas Constitution? If so, can they be characterized, how are they characterized, and does characterization affect who is liable? These questions, and many others, will be explored further, below, but for now it is important to note that whether "debt" can be characterized as community or separate is an important issue.

Third, the Texas Constitution discusses the concept of character only in relation to person who are about to marry and spouses. *See* Tex. Const. art. XVI, §15. Before a marriage takes place, a person owns property with no character. *See* Tex. Const. art. XVI, §15. After a marriage takes place, a person owns community, separate, or mixed property. *Hilley v. Hilley*, 161 Tex. 569, 574, 342 S.W.2d 565, 567-58 (1961)(separate or community); *Gleich v. Bongio*, 128 Tex. 606, 610, 99 S.W.2d 881, 883 (Tex. Comm'n App. 1937)(mixed). Upon divorce, the divorce court divides the parties' community property, typically awarding it as the "sole and separate property" of each spouse or, if any former community property was not divided by the divorce court, then the ex-spouses own such property as tenants in common. *See* Tex. Fam. Code § 7.001 (just and right division); *See e.g., Workings v. Workings*, 700 S.W.2d 251, 253

(Tex.App.—Dallas 1985, no writ)("At the time of the first divorce, the community property held by the parties either became their separate property according to the terms of the purported property agreement, or, if there was no agreement, they became tenants-in-common of undivided separate property"). Although it is common practice for a divorce court to divide community property and award it as "sole and separate property" to a spouse, such a label is probably incorrect, because once spouses are divorced, the ex-spouses once again return to owning property with no character. *See* Tex. Const. art. XVI, §15 (discussing character only in relation to persons who are about to marry and spouses); *Oliver v. Oliver*, 741 S.W.2d 225, 227 (Tex.App.—Fort Worth 1987, no writ)(rejecting argument that division of community property impermissibly creates separate property in violation of the constitution); *see also, Ambrose v. Moore*, 46 Wash. 463, 465–66, 90 P. 588, 589 (1907)("Where no disposition of the property rights of the parties is made by the divorce court, the separate property of the husband prior to the divorce becomes his individual property after divorce, the separate property of the wife becomes her individual property, and, from the necessities of the case, their joint or community property must become common property. After the divorce there is no community, and in the nature of things there can be no community property.").

IV. TEXAS MARITAL LIABILITIES—A DUMPSTER DIVE

Unlike the character of marital property, the liability of married people, and the liability of their property, to third parties is not addressed in the Texas Constitution. Instead, the constitution commands the legislature to pass laws "more clearly defining the rights of the spouses, in relation to separate and community property." *See* Tex. Const. art. XVI, §15. The Texas Supreme Court has concluded that this language gives the legislature broad authority to alter the rights of spouses to manage their property, and to further define the spouses' liability to third parties. *See, e.g., Arnold*, 273 S.W. at 803-05 (rejecting attack on the constitutionality of statute regulating the management of marital property and the liability of such property for either spouses' debts). This section of the paper discusses the current statutory system enacted by the Texas Legislature to further define spousal management rights over marital property and the liability, if any, each spouse has, and his or her property has, to third parties. The discussion begins by debunking a long-existing myth in Texas marital property law.

A. The Myth of "Community Debt"

Can debt be characterized? Is there such a thing as a "community debt"? In thinking about the concept of marital property liability, most attorneys tend to think in terms of separate and community liability. This notion is reflected in the Sworn Inventory and Appraisement form found in the Texas Family Law Practice Manual and other form providers. However, it is important to understand that most experts in marital property law, and more specifically Professor Tom Featherston and Professor Joseph W. McKnight, have long urged that there is no such thing as "community debt." In his 2010 article for the *Texas Bar Journal* entitled "Marital Property Liabilities, Dispelling the Myth of the Community Debt," Professor Featherston flatly states that the concept of community debt is a "mythical concept." Essentially the argument that Professor Featherston and others make is that the concept of community debt arose from opinions expressed in cases that were all decided prior to the Matrimonial Property Act of 1967. It was this act that granted Texas women the right to manage their separate property as well as the right to manage their special community property and share in the equal management of the joint community property owned with their husbands. Under our current law, the Texas Family Code sets out a somewhat disjointed, but logical system for determining liability for debts incurred by spouses both before and during marriage. This system consists of a group of statutes found in our family code, **none** of which refer to or create a "community debt." As Professor Featherston notes, in the case of *Brooks v. Brooks*, 515 SW2d 730, 733 (Tex.App.—Eastland 1974, writ ref'd n.r.e.), the Court of Appeals stated that "Texas statutes do not define the term community property debt," and that is still the case today. Professor Featherston goes on to point out that over 25 years ago Professor Joseph W. McKnight discussed the inaccurate use of the phrase "community debt" in his annual survey of Texas Family Law stating that "under Texas laws amended and recodified in 1969, a community debt means nothing more than **some** community property is liable for satisfaction of the debt." Professor Featherston notes that cases which use the term "community debt" were decided by the Texas Supreme Court in a by-gone era before the pivotal changes that occurred in Texas Marital Property Law over the last 40 years." Professor Featherston states that "Reliance on any pre-1963 case is not likely to be good authority to resolve an issue

involving marital property liability today.[1]" Recall 1963 is when the disability of coverture was abolished allowing women to freely contract in their own name for the first time in Texas history.

The myth of the "community debt" came crashing down to earth in the Texas Supreme Court's opinion in *Tedder v. Gardner Aldrich*, LLP, 421 S.W.3d 651, 654 (Tex. 2013). That case dealt with whether attorney's fees incurred by wife in obtaining a divorce were either a "community debt" or necessaries for which her husband could be held liable. The wife's former attorney sued seeking to recover his fees from husband as either a "community debt" or as necessaries. The Court rejected both of the attorney's claims and stated the following regarding the attorney's "community debt" argument:

> Confusion over the significance of "community debt" has been ascribed to our opinion in *Cockerham v. Cockerham*, where we said 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 spouse for satisfaction." We immediately added: "[T]he fact that the debts are community liabilities would not, without more, necessarily lead to the conclusion they were joint liabilities. Characterization of the debts as community liabilities is only one aspect of the circumstances to be considered in determining whether the debts are joint." But the first statement, and the entire analysis, has proved misleading. As Professor Joseph McKnight explained thirty years ago:
>
> Much of the judicial discussion of "community debt" is based on the erroneous supposition that all "community debts" are equally shared by the spouses whether they are both makers of the debt or not. That supposition is not warranted by the basic principles of Texas law. Apart from the context of acquiring necessaries, debt incurred by only one spouse does not affect the other spouse at all except that it makes the nonobligated spouse's share of community property liable for payment if the property sought for payment is subject to the sole or joint management of the spouse who incurs the debt.
>
> It is high time that the community debt argument be put to rest. 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 [of the Family Code, currently Section 3.202]. 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.
>
> Professor Featherston has succinctly observed, "[m]arriage itself does not create joint and several liability." These and other commentators agree that one spouse's liability for debts incurred by or for the other is determined by statute. We agree.

Tedder, 421 S.W.3d at 654–55.

In summary, there is no such thing as a "community debt" outside of the limited circumstance when money or property is acquired during marriage by a debt transaction wherein the lender does not agree to look to one spouse's separate estate for repayment. As a result, all discussions of spousal liability and the liability of marital property for a spouse's debts, must focus on the language in the Texas Family Code regarding management, disposition, and control of marital property, the liability of spouses for the acts of the other spouse, as well as the potential liability of marital property to satisfy the claims of creditors for debts incurred before or during marriage. *See e.g.*, Tex. Fam. Code §§ 3.101-3.203.

B. Texas Law Regarding Marital Liabilities

The Texas Legislature has enacted a logical liability process that uses a multi-step process to determine which nonexempt assets of the spouses is liable for which debts during marriage. Tom Featherston, Marital Property Liability: Post *Tedder*, Texas Family Law Section, Section Report (September 2017). This process involves answering four basic questions:

1. When was the debt incurred? (The answer is going to be either before or during marriage).
2. Whose debt is it? (husband, wife, or by both spouses jointly).

[1] *Texas Bar Journal*, "Marital Property Liabilities, Dispelling the Myth of the Community Debt" by Professor Tom Featherston, pg. 2.

3. What type of debt is it? (tortious, contractual, or necessaries?).
4. If the debt was not for necessaries, then was the spouse who incurred the debt acting as the other spouse's agent? Thereby creating vicarious liability.

Bearing these questions in mind, the following is an analysis of the pertinent Family Code sections that relate to the determination of what debts a spouse is liable for and which marital assets can be taken in order to satisfy that debt. This determination is largely governed by Chapter 3 of the Texas Family Code, Marital Property Rights and Liabilities, Subchapter C., Marital Property Liabilities. The core concepts of Subchapter C are as follows:

C. Spousal Liability: When Does a Spouse Become Liable for the Acts of Their Spouses?

Texas Family Code Section 3.201 states that:

"(a) A person is personally liable for the acts of the person's spouse only if:
(1) the spouse acts as an agent for the other person; or
(2) the spouse incurs a debt for necessaries as provided by Subchapter F, Chapter 2 (2.501).
(b) Except as provided by this subchapter, community property is not subject to a liability that arises from an act of a spouse.
(c) A spouse does not act as an agent for the other spouse solely because of the marriage relationship."

Section 3.201 lays out the circumstances under which one spouse becomes personally liable for the acts of their spouse. As plainly stated in the statute, this only occurs when one spouse acts as the agent for the other spouse or a spouse incurs debt for necessaries as provided by Tex. Fam Code Section 2.501 "Duty to Support." Section 2.501 provides that each spouse has a duty to support their spouse. If a spouse fails to "discharge the duty of support" for their spouse, he or she becomes "liable to any person who provides necessaries" to their spouse.

1. The "Agent" Spouse

Section 3.201 raises two issues, when does a spouse act as their spouse's "agent" and what are necessaries? As to question number one, the statute clearly states that merely being man and wife does not create an agency relationship, so what does? For the answer to this question one must look at the law of agency and the applicable case law.

a. The *Cockerham* Case

The case of *Cockerham v Cockerham*, 527 S.W. 2d 167 (Tex. 1975) has been cited as an example of how one spouse can become obligated for debts clearly incurred by their spouse. This case has been mistakenly cited in older cases to support the concept of an "agent" spouse or to infer a broader liability for debts incurred by one spouse with merely the acquiescence of the other. As discussed above, *Cockerham* is one of the pre-1963 cases Professors Featherston and McKnight urged practitioners and courts to ignore insofar as its effect as good authority for today's marital property liability questions, in light of the enactment of Tex. Fam. Code § 4.03 in 1987, now recodified as Tex. Fam. Code § 3.201. In fact, this statute was enacted in reaction to *Cockerham*. At issue in *Cockerham* was the liability for debts incurred by the wife in her dress shop business. The facts in *Cockerham* included evidence that the non-contracting husband had given "implied assent" to his wife incurring debts in connection with her dress shop, that the husband acquiesced in the wife's operation of a dress shop, and that they received the benefit of business losses on a joint tax return. These and a few other factors, were sufficient for a majority of the Court to find that the dress shop debts were a joint obligation of the parties making Mr. Cockerham's separate property interest in a tract of land liable for those obligations. Three judges dissented, arguing that, except for necessaries of the other spouse, a non-contracting spouse should be liable "only to the extent and under the same rules of law that would make a non-family party liable." laws such as the laws of agency.

b. Squaring Texas Family Code § 3.201 with *Cockerham*

Bearing in mind that 3.201 was first enacted as Tex. Fam. Code § 4.031 in 1987 some twelve years after the ruling in *Cockerham*, did our subsequent statute render *Cockerham* moot? Professor Featherston, other prominent authors and common sense said "yes", one stating that "In the Author's estimation, Section 3.201 confirms into law the reasoning of the dissenters in *Cockerham*." The dissent had argued that unless necessaries are at issue, a spouse should be liable "only to the extent and under the same rules of law that would make a non-family party liable." The Texas Supreme Court essentially agreed in *Tedder*, abrogating *Cockerham* and holding that Section 3.201 controls decisions regarding spousal liability for debts. *Tedder*, 421 S.W.3d at 655.

In short, were *Cockerham* to be decided today, the court holding would be based on Texas Family Code Section 3.201 and Mr. Cockerham's separate property interest in the tract of land at issue would be exempt from liability for the dress shop debts incurred by his wife, for the simple fact that he did not act as an agent for his spouse by merely failing to put up a fuss over her incurring dress shop debt. But what about the issue of necessaries?

2. When Does a Spouse Acquire Liability for Necessaries Incurred by Their Spouse?

As to the issue of necessaries, the concept of 2.501 Section is direct. When you marry, you acquire a legal duty to support your spouse and vice versa. If you fail to support your spouse and someone else provides "necessaries" for her, you are liable for the payment for these necessaries. Webster's defines a necessary as "that which cannot be dispensed with, essential, indispensable." It is the author's opinion that in today's society this concept rarely comes into play where actual creditors are concerned other than with respect to legal fees, as *Tedder* demonstrates.

a. What Constitutes a Necessary?

In looking at what has constituted "necessaries" under Texas Law, this excellent compilation of cases that have addressed the issue of necessities between 1854 and 1969 is offered, as compiled by Kyle Sanders for his article *Liabilities and Debt: A Subprime Divorce*, State Bar of Texas, Marriage Dissolution Institute, 2009:

"The term 'necessaries' is not susceptible to exact definition. Whether a liability incurred by a spouse is for necessaries is a question of fact to be determined from the facts and circumstances of each case. *Crooks v. Aero Mayflower Transit Co., Inc.*, 363 S.W.2d 191, 192 (Tex.Civ.—App.San Antonio 1962, writ ref'd n.r.e.). A determination of what is 'necessary' depends upon what is reasonable and proper for persons in the spouse's 'station of life.' *Daggett v. Neiman Marcus, Co.*, 348 S.W.2d 796, 799 (Tex.Civ.App.—Houston, [1st Dist.] 1961, no writ.) Minimal necessaries include food, clothing, and shelter. *See Wadkins v. Dillingham*, 59 S.W.2d 1099, 1100 (Tex.Civ.App.—Austin 1933, no writ). However, items also held to be necessaries include cosmetics, *Gabel v. Blackburn Operating Corp.*, 442 S.W.2d 818, 820 (Tex.Civ.App.—Amarillo 1969, no writ); airline tickets, *Jarvis v. Jenkins*, 417 S.W.2d 383, 384 (Tex.Civ.App.—Waco 1967, no writ); and a piano, *Lee v. Hall Music Co.*, 35 S.W.2d 685 (Tex. 1931). The term is used to designate such things as are suitable to the station in life of the spouse and children, insofar as the ability of the parties will permit. *Walling v. Hannig*, 73 Tex. 580 (1889); *Milburn v. Walker*, 11 Tex. 329 (1854). Conditions and stations in life of parties are to be considered in determining whether articles purchased by Wife are necessary, and ordinarily she is judged thereof, subject to satisfying court and jury that articles are reasonable and proper. *Daggett v. Neiman-Marcus Co.*, 348 S.W. 2d 796 (Tex.Civ.App.—Houston [1st Dist.], 1961). *See also Wadkins v. Dillingham*, 59 S.W.2d 1099 (Tex.App.—Austin 1933). Whether contract executed by Wife is for necessaries is generally question of fact to be determined from facts and circumstances of particular case. *Crooks v. Aero Mayflower Transit Co.*, 363 S.W.2d 191 (Tex.App.—San Antonio 1962, writ ref'd n.r.e.). Term "necessaries" encompasses such services as Husband is financially able to, and should, provide for Wife's benefit and that are suitable to provide for Wife's benefit and that are suitable to maintenance of condition and station in life family occupies. *Approved Personnel Service v. Dallas*, 358 S.W.2d, 150 (Tex.App.—Texarkana, 1962). What constitutes necessaries for the wife or children depends entirely on the facts and circumstances of the particular case. Examples are:

The purchase, *Bexar Bldg. & Loan Ass'n v. Heady*, 50 S.W.2d 1079 (Tex.Civ.App. 1899), rental, *Harris v. Williams*, 44 Tex. 124 (1875); *Wadkins v. Dillingham*, 59 D.W.2d 1099 (Tex.App.—Austin 1933), construction, *Howell v. McMurray Lumber Co.*, 132 S.W. 848 (Tex.Civ.App.1910, writ dism'd), and furnishing of a house for the use of the family, *Desmond v. Dockery*, 116 S.W. 114 (Tex. Civ. App. 1909) (rooming house). Purchase of piano by Wife who traded in old one established that piano was necessary household article. *Oliver H. Ross Piano Co. v. Walker*, 111 S.W.2d 1165 (Tex.App.—Fort Worth 1937);

The purchase of suitable food and clothing for the wife and children, *Gabel v. Blackburn Operating Corp.*, 442 S.W.2d 818 (Tex.App.—Amarillo 1969) (holding that evidence was sufficient to support jury finding that clothing and cosmetics purchased from department store were necessaries); *Corbett v. Wade*, 124 S.W.2d 889 (Tex.App.—Austin 1939); *Colonna v. Kruger*, 246 S.W.707 (Tex.Civ.App. 1922); *Ellis v. Emil Blum Co.*, 242 S.W. 1099 (Tex.Civ.App. 1922).

The purchase of a family automobile, *Allied Finance Co. v. Butaud*, 347 S.W.2d 366 (Tex.App.—Dallas 1961); *Fallin v. Williamson Cadillac Co.*, 40 S.W.2d 243 (Tex.App.—San Antonio 1931); *Guaranty State Bank v. Franklin Fire Ins. Co.*, 262 S.W. 769 (Tex.Civ.App. 1924, writ dism'd);

Expenditures incurred on behalf of a child, as for its tuition, *Bradley v. Gilliam*, 260 S.W. 289 (Tex.Civ.App. 1924); but *see Haas v. American Nat. Bank*, 94 S.W. 439 (Tex.Civ.App. 1906) (tuition for child brought into family without husband's consent does not come under heading of "necessaries.")

Expenses incurred for medical and dental services for the family, *Black v. Bryan*, (1857) 18 Tex. 453) *see also Corbett v. Wade*, 124 S.W.2d 889 (Tex.App.—Austin 1939)(husband's liability extends to nursing care furnished wife); *Meinen v. Muesse*, 72 S.W.2d 931 (Tex.App.—Austin 1934)(nurse's and housekeeper's services are necessaries); and *White v. Lubbock Sanitarium Co.*, 54 S.W.2d 1058 (Tex.App.—Amarillo 1932, writ dism'd w.o.j.) (medical services rendered wife by sanitarium are necessaries). Note that Kyle Sanders correctly interpreted *Carle* and thus did not include it in his list of cases.

However, note that there are no cases cited by Sanders after 1969 for the reason that almost all of these cases were decided before the removal of coveture in 1963 and the enactment of the Matrimonial Property Act of 1967. As Professor Featherston stated, those cases pre-dating 1963 may lack persuasive authority today.

b. Legal Fees as Necessaries Before *Tedder*

Before *Tedder*, reasonable fees for the services of an attorney to represent the wife in a divorce suit were often categorized as necessaries. Note the following:

Roberts v. Roberts, 192 S.W.2d 774 (Tex. 1946)(allowing recovery of Wife's attorney's fees as necessaries after dismissal of the divorce case for Husband's failure to meet the residency requirements).

Petrovich v. Vautrain, 730 S.W.2d 857, 861 (Tex.App.—Forth Worth 1987, writ ref'd n.r.e.)(holding that divorce attorney may sue opposing client in a separate lawsuit); *Navarro v. Brannon*, 616 S.W.2d 262, 263 (Tex.Civ.App.—Houston [1st Dist.] 1981, writ ref'd n.r.e.)(reversing and remanding dismissal of attorney's intervention to recover fees incurred on behalf of Wife before Husband and Wife reconciled; holding Wife's attorney's fees are necessaries if she acts in good faith and on probable cause); *Schwartz v. Jacob*, 394 S.W.2d 15, 21 (Tex.Civ.App.—Houston 1965, writ ref'd n.r.e.)(Wife's attorney's fees may be recovered from Husband as necessaries; there is no statute or rule allowing them; Husband has a common law obligation to furnish necessaries for the wife and children.

Flippin v. Hamilton, 2005 Tex. App. LEXIS 5420, *1, 3, 5 (Tex.App.—Dallas July 13, 2005, no pet); *Navarro v. Brannon*, 616 S.W.2d 262, 263 (Tex.Civ.App.—Houston [1st Dist.] 1981, writ ref'd n.r.e.)(reversing and remanding dismissal of attorney's intervention to recover fees incurred on behalf of Wife before Husband and Wife reconciled; holding Wife's attorney's fees are necessaries if she acts in good faith and on probable cause); *Myers v. Myers*, 503 S.W.2d 404, 405 (Tex.Civ.App.—Houston [14th Dist.] 1973, no writ), post-trial mandamus denied, 515 S.W.2d 334, 335-36 (Tex.Civ.App.—Houston [1st Dist.] 1974, orig. proceeding); *Schwartz v. Jacob*, 394 S.W.2d 15, 21 (Tex.Civ.App.—Houston 1965, writ ref'd n.r.e.)(Wife's attorney's fees may be recovered from Husband as necessaries; there is no statute or rule allowing them; Husband has a common law obligation to furnish necessaries for the Wife and children).

While most of these cases were decided after the pivotal year for women's rights, 1963, none are mentioned in the portion of the *Tedder* opinion which holds that attorney's fees incurred in seeking a divorce are, as a matter of law, not a necessary regardless of a person's station in life.

3. <u>One Final Observation about Section 3.201.</u>

Section 3.201 focuses on when one spouse becomes liable for the acts of his or her spouse. Texas Family Code Chapter 3, Subchapter C, contains no provisions addressing when a spouse becomes liable for his or her own debts, because that subject is covered by the general laws of this State governing creditor-debtor relationships and no special provision is needed in the Family Code to govern such liabilities.

D. Marital Property Liability: What Marital Property is Available to Pay What Debt?

Section 3.202 is entitled "Rules of Marital Property Liability" and it governs the potential liability of marital property to pay debts incurred before or during marriage. *See* Tex. Fam. Code § 3.202. Its sets forth rules of property liability based upon the classification of property as separate property, sole management community property, and joint management community property and a spouse's ability to manage and control that property. Thus, the reader needs to know about the classes of marital property and each spouse's rights of management and control over such property.

1. <u>Texas' System of Divided Management and Control of Marital Property.</u>

Sections 3.101 and 3.102 create a statutory scheme for the divided management and control of marital property.

a. Separate Property

Texas Family Code Section 3.101 states that "Each spouse has the sole management, control, and disposition of that spouse's separate property.

b. Community Property

Texas Family Code Section 3.102 states what community property is subject to the sole management, control, and disposition of a spouse, and that which is subject to joint management of the spouses. Section 3.102 states that as to Sole Management:

> (a) During marriage, each spouse has the sole management, control, and disposition of the community property that the spouse would have owned if single, including:
>
> (1) personal earnings;
> (2) revenue from separate property;
> (3) recoveries for personal injuries; and
> (4) the increase and mutations of, and the revenue from, all property subject to the spouse's sole management, control, and disposition.

As to Joint Management, 3.102 goes on to say:

> (b) If community property subject to the sole management, control, and disposition of one spouse is mixed or combined with community property subject to the sole management, control, and disposition of the other spouse, then the mixed or combined community property is subject to the joint management, control, and disposition of the spouses, unless the spouses provide otherwise by power of attorney in writing or other agreement.

Finally, Section 3.102 states that:

> (c) Except as provided by Subsection (a), community property is subject to the joint management, control, and disposition of the spouses unless the spouses provide otherwise by power of attorney in writing or other agreement.

Bear in mind, however, all of the rules set out in Texas Family Code Section 3.102 can be altered by pre or post marital agreements between the spouses, including a partition agreement.

2. Rules of Marital Property Liability.

Texas Family Code Section 3.202 sets forth the rules regarding the liability of marital property for the payment of debts incurred by the spouses before or during marriage. *See* Tex. Fam. Code § 3.202. It states:

> (a) A spouse's separate property is not subject to liabilities of the other spouse unless both spouses are liable by other rules of law.
>
> (b) Unless both spouses are personally liable as provided by this subchapter, the community property subject to a spouse's sole management, control, and disposition is not subject to:
>
> (1) any liabilities that the other spouse incurred before marriage; or
> (2) any nontortious liabilities that the other spouse incurs during marriage.
>
> (c) The community property subject to a spouse's sole or joint management, control, and disposition is subject to the liabilities incurred by the spouse before or during marriage.
>
> (d) All community property is subject to tortious liability of either spouse incurred during marriage.
>
> (e) For purposes of this section, all retirement allowances, annuities, accumulated contributions, optional benefits, and money in the various public retirement system accounts of this state that are community property subject to the participating spouse's sole management, control, and disposition are not subject to any claim for payment of a criminal restitution judgment entered against the nonparticipant spouse except to the extent of the nonparticipant spouse's interest as determined in a qualified domestic relations order under Chapter 804, Government Code.

For quick reference, the rules set out in Texas Family Code 3.202 can be summarized as follows:

a. Property at Risk for Payment of Husband's Pre-Marital Liabilities
    1. Husband's Separate Property
    2. Husband's Sole Management Community Property
    3. The Spouses' Joint Management Community Property

b. Property at Risk for Payment of Wife's Pre-Marital Liabilities
   1. Wife's Separate Property
   2. Wife's Sole Management Community Property
   3. The spouses' Joint Management Community Property
c. Property at Risk for Payment of Husband's Post-Marital Liabilities – Non-Tortious
   1. Husband's Separate Property
   2. Husband's Sole Management Community Property
   3. The Spouses' Joint Management Community Property
d. Property at Risk for Payment of Wife's Post Marital Liabilities – Non-Tortious
   1. Wife's Separate Property
   2. Wife's Sole Management Community Property
   3. The Spouses' Joint Management Community Property
e. Property at Risk for Payment of Husband's Tortious Liability Incurred During Marriage
   1. Husband's Separate Property
   2. All Community Property, regardless of the spouse who has the right to manage the property
f. Property at Risk for Payment of Wife's Tortious Liability Incurred During Marriage
   1. All Wife's Separate Property
   2. All Community Property, regardless of the spouse who has the right to manage the property

For the best, quick reference guide on this subject, *see* Appendix "A" to this article, an excellent chart prepared by Richard Orsinger for his 2009 article *Practicing Law in a Depressed Economy*. Tear it off and keep it handy, as this chart quickly identifies the debts for which a husband or wife are liable.

3. Meaning and Effect of Section 3.202.

There are several fundamental observations that need to be made about Section 3.202.

First, Section 3.202 only applies to married people. Section 3.202 is entitled "Rules of *Marital* Property Liability." It uses the term "spouses" and makes no mention of persons about to marry or person who were formerly married. Thus, the focus of Section 3.202 is on the property owned by married people and whether it is "subject to" the various types of liabilities incurred by those people.

Second, Section 3.202 only addresses liabilities incurred by spouses before or during marriage. It simply does not address liabilities incurred by former spouses after a marriage is dissolved.

Third, Section 3.202 is, in its practical application, an exemption statute. *Medaris v. United States*, 884 F.2d 832, 833 (5th Cir. 1989)(interpreting former Family Code Section 5.61, now Section 3.202, and discussing what marital property was exempt from levy for payment of wife's premarital income tax debt). This point is very important, but it is hard to glean from the text of the statute because the statute does not speak in terms of exemptions, it speaks in terms of different categories of property being "*subject to*" different categories of liabilities incurred by the spouses before or during marriage. Nonetheless, the net effect of the statute is to make certain categories of marital property exempt from the payment of certain categories of liabilities of the spouses. For example, one spouse's sole management community property "is not subject to" the other spouse's tortious or non-tortious liabilities incurred before marriage or non-tortious liabilities incurred during marriage. *See* Tex. Fam. Code. § 3.202(b). However, if the other spouse incurred a tortious liability during the marriage, then all the spouses' community property is "subject to" the liability and may be levied upon once a judgment is obtained and a writ of execution is issued, including the innocent spouse's sole management community property. *Compare* Tex. Fam. Code. § 3.202(b) *with* 3.202(d).

These three observations are important points to remember when interpreting and applying Section 3.202, and they will be helpful to remember when this paper turns to discussing the rights of unsecured creditors after the dissolution of a marriage, in Section VI below.

4. Effect of Agreements with Creditors

It should be noted that the ordinary rule set out in Texas Family Code § 3.202(c), that the community property subject to a spouse's sole or joint management, control, and disposition is subject to the liabilities incurred by that spouse before or during marriage, is not true in instances where a creditor has contracted away the right to seek recovery from community property. For example, a "non-recourse" note pledging a specific asset as collateral can be collected only out of the collateral placed for the note and not from any other source, community or separate. A "separate property debt" (i.e., where the creditor has agreed to look solely to the borrowing spouse's separate estate for

repayment) cannot be collected out of any community property, even that which is subject to the sole or joint management of the debtor.

The only other exception to the rules set out at Tex. Fam. Code 3.202 is found at Texas Family Code Section 3.102(c) which states that the management rights over property set out at Section 3.102 (a) through (c) may be altered by power of attorney in writing or other agreement between the spouses. These other agreements include pre- or post-marital agreement including a Partition Agreement as defined at Tex. Fam. Code 4.102, which will be discussed later in this article.

5. Additional Creditor Protection – TX. Fam. Code 3.104

Tex. Fam. Code Section 3.104 – Protection of Third Persons - provides that:

(a) During marriage, property is presumed to be subject to the sole management, control, and disposition of a spouse if it is held in that spouse's name, as shown by muniment, contract, deposit of funds, or other evidence of ownership, or if it is in that spouse's possession and is not subject to such evidence of ownership.

(b) A third person dealing with a spouse is entitled to rely, as against the other spouse or anyone claiming from that spouse, on that spouse's authority to deal with the property if:

(1) the property is presumed to be subject to the sole management, control, and disposition of the spouse; and

(2) the person dealing with the spouse:

(A) is not a party to a fraud on the other spouse or another person; and

(B) does not have actual or constructive notice of the spouse's lack of authority.

The final code section that impacts our clients who are dealing with issues concerning marital liabilities on divorce is Family Code Section 3.203 which tells us in what order marital property is subject to execution for a money judgment held by a creditor of one or both spouses. Note that Section 3.203 does allow for some arguments regarding fairness to come into play in making these determinations.

E. Family Code Section 3.203--The Texas Marshalling Statute

Section 3.203 of the code, entitled "Order in Which Property is Subject to Execution," gives Texas courts the power to "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." It states:

(a) a judge may determine, as deemed just and equitable, the order in which particular separate or community property is subject to execution and sale to satisfy a judgment, if the property subject to liability for a judgment includes any combination of:

(1) a spouse's separate property;

(2) community property subject to a spouse's sole management, control, and disposition;

(3) community property subject to the other spouse's sole management, control, and disposition; and

(4) community property subject to the spouses' joint management, control, and disposition.

(b) In determining the order in which particular property is subject to execution and sale, the judge shall consider the facts surrounding the transaction or occurrence on which the suit is based.

To date, this statute has never been definitively discussed by a Texas appellate court in any context. It was mentioned, in passing, in *Fischer v. Klein*, with regard to wife's arguments about wrongful seizure of her interest in allegedly exempt property, but no substantive discussion of the statute's language was undertaken. *Id.*, No. 03-10-00310-CV, 2014 WL 5420405, at *2 (Tex.App.—Austin Oct. 23, 2014, no pet.).

The only case discussing this statute in detail is a federal tax case. *Estate of Fulmer v. Comm'r*, 83 T.C. 302 (1984)(interpreting former code sections 5.61 and 5.62, now Sections 3.202 and 3.203). In that case, a shootout between an apartment owner (Fulmer) and husband-and-wife managers (the Riders) left the owner dead and both managers wounded. *See Fulmer v. Rider*, 635 S.W.2d 875, 876 (Tex. App.—Tyler 1982, writ ref'd n.r.e.). The Riders recovered a tort judgment against Fulmer's estate. *Estate of Fulmer*, 83 T.C. at 302. Under the literal wording of the Family Code, all Fulmer's separate property and all community property was available to satisfy the judgment because the judgment was a judgment in tort. *See* former Family Code Section 5.61 and current version, Tex. Fam. Code § 3.202(a), (d). Only Mrs. Fulmer's separate property was exempt under the statute. *Id.* Relying on Section 3.203's

predecessor statute, former Section 5.61, the probate court determined it would be "just and equitable" that the victims collect their tort judgment from Mr. Fulmer's estate's half-interest in the community—Mr. Fulmer being the tortfeasor and Mrs. Fulmer an innocent spouse. *Id*. at 304. The executor then deducted the full judgment amount in computing federal tax liability. *Id.*

The IRS objected, contending that the Texas Family Code provides that all community property is subject to the tortious liability of either spouse, and that since the torts of the decedent occurred during marriage, the liabilities therefore attached to the community property of the decedent and his wife. *Id*. Thus, the IRS asserted that only one-half of such liabilities are properly payable and deductible by the estate. *Id*. The United States Tax Court sided with the estate, holding that the probate court's action was a proper use of the marshalling statute. *Id*. at 309. In making its decision, the Court said the following with regard to the Texas marshalling statute:

> In interpreting sections 5.61 and 5.62 of the Texas Family Code, we are bound by the decisions of the Supreme Court of Texas. However, since that court has not considered such provisions in a context similar to that before us in the present case, we must apply what we find to be the state law after giving 'proper regard' to relevant rulings of other courts of the State. *Commissioner v. Estate of Bosch*, 387 U.S. 456, 465 (l967); *Padre Island Thunderbird, Inc. v. Commissioner*, 72 T.C. 391, 395 (1979). 'In this respect, * * * (we) may be said to be, in effect, sitting as a state court. *Commissioner v. Estate of Bosch*, supra at 465.
>
> Section 5.62 of the Texas Family Code is a marshalling statute. *See* 3 L. Simpkins, Texas Family Law with Forms secs. 20:23, 20:28, 34:1, 34:8 (Speer's 5th ed. 1976); McKnight, 'Management, Control and Liability of Texas Marital Property', 2 Community Prop. J. 76, 81 (1975). The Family Law Section of the State Bar of Texas prepared in 1966 a proposed revision of the Texas Matrimonial Property Law. In the accompanying explanation which was distributed to the Texas Legislature, it was stated:
>
> Under the present law the creditor can reach whatever he can find to satisfy his judgment unless an equity of marshalling is asserted. It will be the responsibility of a spouse to assert this doctrine if he or she should desire to take advantage of it. Upon proper pleadings in the alternative the spouses can protect themselves in the event liability is found. However, unless the statute is plead, the Doctrine of Creditor's Choice would still apply.
>
> Thus, the provisions of sections 5.61(d) and 5.62 are wholly consistent. Under section 5.61(d), all the community property of both spouses is subject to the tortious liability of either spouse incurred during marriage. *Lawrence v. Hardy*, supra; *de Anda v. Blake*, supra; 3 L. Simpkins, Texas Family Law with Forms, supra at secs. 20:10, 20:16, 34:1, 34:8. *See generally* W. de Funiak & M. Vaughn, Principles of Community Property secs. 181-182 (2d ed. 1971); 1 J. McChey, Valuation & Distribution of Marital Property sec. 20.07(3) (1984); W. McClanahan, Community Property Law in the United States secs. 10:1-10:9 (1982). Section 5.62 provides only that a court may, as equitable considerations require, determine the order in which property is to be used to satisfy a judgment against one of the spouses.
>
> Other community property States similarly provide for the equitable marshalling of assets. *See, e.g.*, California: Cal. Civ. Code sec. 5122 (West 1983); *Tinsley v. Bauer*, 125 Cal. App. 2d 714, 271 P.2d 110 (Dist. Ct. App. 1954); *McClain v. Tufts*, 83 Cal. App. 2d 140, 187 P.2d 818 (Dist. Ct. App. 1947). New Mexico: N. M. Stat. Ann. sec. 40-3-10 (1983); *Dell v. Heard*, 532 F.2d 1330 (10th Cir. 1976); *Herrera v. Health and Social Services*, 92 N.M. 331, 587 P.2d 1342 (Ct. App. 1978). Washington: *de Elche v. Jacobsen*, 95 Wash. 2d 236, 622 P.2d 835 (1980); *Casa del Rey v. Hart*, 31 Wash. App. 532, 643 P.2d 900 (1982). Louisiana and Washington provide that if community property is used to satisfy a spouse's separate obligation then the other spouse has a right of reimbursement upon termination of the marriage. Louisiana: La. Civ. Code Ann. arts. 2345, 2364, 2365 (West 1984 Supp.); *Cloud v. Cloud*, 425 So.2d 329 (La. Ct. App. 1982); *Deliberto v. Deliberto*, 400 So.2d 1096 (La. Ct. App. 1981). Washington: *de Elche v. Jacobsen*, supra; *In re Marriage of Harshman*, 18 Wash. App. 116, 567 P.2d 667 (1977). *See generally* W. McClanahan, Community Property Law in the United States sec. 10:7 (1982). So far as we have been able to ascertain, the Texas courts have not decided whether there is a similar right of reimbursement in Texas, but the fact that the courts in other community property States have allowed for such reimbursement provides some reason to believe that the Texas courts would reach a similar conclusion. If the surviving spouse would have had a right of reimbursement in the event that the tort claims had been paid out of her share of community property, the existence of such right would confirm the action taken by the Texas courts in directing that the claims be paid out of the decedent's share of community property.

> We recognize that the Commissioner is not bound by a State court judgment to which he was not a party. *Pesch v. Commissioner*, 78 T.C. 100, 129 (1982); *Bruner v. Commissioner*, 39 T.C. 534, 537 (1962). Nor are we bound to accept a Texas trial court's interpretation and application of Texas law. Yet, in our judgment, the Texas courts did properly construe and apply the provisions of section 5.61(d) and section 5.62 of the Texas Family Code. Under section 5.61(d), the court claimants had a right to seek recovery from any and all community property, and their claims could not have been defeated by any marshalling of assets under section 5.62. However, under section 5.62, the courts had the authority to order a marshalling of the assets and to direct that the tort claims be first paid out of the decedent's share of community property if that share was sufficient. Since the tort claims were in fact paid out of such share in accordance with Texas law, the amount of such payments was deductible by the estate, and the related attorney's fees were also properly payable by the estate and deductible by it.

Estate of Fulmer, 83 T.C. at 306-08.

While no Texas appellate court has definitely construed the Texas marshalling statute yet, the Tax Court's analysis in *Estate of Fulmer* bears remembering. This is true especially because at least one Texas appellate court has recognized a right of reimbursement when community property is used to pay a judgment debt owed solely by the other spouse since *Estate of Fulmer* was decided. *See Knight v. Knight*, 301 S.W.3d 723, 731 (Tex.App.—Houston [14th Dist.] 2009, no pet.).

The impact of Section 3.203 on divorces, and spousal liability after divorce, remains unclear. This is so because the Fulmer marriage ended in death. Thus, "it was easy to raise the marshalling statute in the course of winding up estate affairs" because State law addresses the treatment of debt in this context. Paulsen, 63 Baylor L. Rev. at 843. "Things would be more complicated in a divorce since creditors are not required to intervene, and the innocent spouse may not even know the debt exists." *Id*. Thus, how the Texas marshalling statute works at the time of divorce or after divorce remains undecided.

F. Other Statutes Effecting Debt Collection

Obviously, there are other statutes that come into play in assessing what assets may be taken to satisfy debts and that is the statute delineating what marital assets are exempt from the claims of an unsecured creditor. Those statutes are primarily TX Prop. Code § 42.001 and 42.002, which exempt the following from garnishment, attachment, execution or other seizure:

1.) PROP § 42.001 PERSONAL PROPERTY EXEMPTION:

(a) Personal property, as described in Section 42.002, is exempt from garnishment, attachment, execution, or other seizure if:

(1) the property is provided for a family and has an aggregate fair market value of no more than $60,000, exclusive of the amount of any liens, security interests, or other charges encumbering the property; or

(2) the property is owned by a single adult, who is not a member of a family, and has an aggregate fair market value of no more than $30,000, exclusive of the amount of any liens, security interests, or other charges encumbering the property.

(b) The following personal property is exempt from seizure and is not included in the aggregate limitations prescribed by Subsection (a):

(1) current wages for personal services, except for the enforcement of court-ordered child support payments;

(2) professionally prescribed health aids of a debtor or a dependent of a debtor;

(3) alimony, support, or separate maintenance received or to be received by the debtor for the support of the debtor or a dependent of a debtor; and

(4) a religious bible or other book containing sacred writings of a religion that is seized by a creditor other than a lessor of real property who is exercising the lessor's contractual or statutory right to seize personal property after a tenant breaches a lease agreement for or abandons the real property.

2.) PROP § 42.002, PERSONAL PROPERTY:

(a) The following personal property is exempt under Section 42.001(a):

(1) home furnishings, including family heirlooms;

(2) provisions for consumption;

(3) farming or ranching vehicles and implements;
(4) tools, equipment, books, and apparatus, including boats and motor vehicles used in a trade or profession
(5) wearing apparel;
(6) jewelry not to exceed 25 percent of the aggregate limitations prescribed by Section 42.001(a);
(7) two firearms;
(8) athletic and sporting equipment, including bicycles;
(9) a two-wheeled, three-wheeled, or four-wheeled motor vehicle for each member of a family or single adult who holds a driver's license and who does not hold a driver's license but who relies on another person to operate the vehicle for the benefit of a nonlicensed person;
(10) the following animals and forage on hand for their consumption:
(A) two horses, mules, or donkeys and a saddle, blanket, and bridle for each;
(B) 12 head of cattle;
(C) 60 head of other types of livestock; and
(D) 120 fowl; and
(E) 11 household pets.

3.) Worker's comp. Tex. Rev. Civ. State. Ann. Art. 8306, §§ 3(b), 8a.

4.) College Savings Plans. Tex. Prop. Code § 42.0022.

G. Recap of The General Rules for Marital Property Liability:

"The Texas Family Code's general rule for property liability is that all property designated as subject to one spouse's "management"—that is, all that spouse's separate property and sole-management community property, as well as all joint-management community property—is liable for that spouse's debts." Paulsen, The Unsecured Texas Creditor's Post-Divorce Claim to Former Community Property, 63 Baylor L. Rev. 781, at 787 (2011). "The non-involved spouse's separate property and that spouse's sole-management community property is safe." *Id.* "If one spouse commits a tort during marriage, the statutory net widens." *Id*. "All the tortfeasor spouse's separate property and all community property is at risk; only the non-tortfeasor spouse's separate property is safe." *Id*. The following examples, used by Professor Paulsen in his paper, might help the reader grasp better the general rules:

> Both husband and wife work. They deposit their earnings into separate bank accounts. They inherit their respective parents' homes, which they maintain as rental properties. They also pool some of their income to buy a vacation home, taking title in both names. They do not keep any records or otherwise recall how much of each spouse's earnings went into the purchase price of the vacation home. The rent houses are each spouse's respective separate property because they are inherited. The bank accounts are their respective sole-management community property because each would have owned the funds on deposit if single. The vacation home is joint-management community property because it was bought with commingled funds.
>
> Now suppose the husband signs and later defaults on a promissory note. The husband's inherited rent house, his bank account, and the vacation home are exposed to the creditor's post-judgment collection efforts. The wife's bank account (sole-management community property) and inherited rent house (separate property) are not. However, if the husband is judged negligent in an auto accident, his inherited rent house, the vacation home, and both bank accounts are placed at risk. Only the wife's inherited rent house (her separate property) is safe.

Paulsen, 63 Baylor L. Rev. at 787–88.

V. MARITAL LIABILITY AND DISSOLUTION OF MARRIAGE

The liability rules set forth in Section IV, above, apply during marriage. When a marriage ends, different rules come into play depending upon whether the marriage ends in death or divorce. Because the rules differ, each is discussed separately.

A. Death

Death dissolves the community estate. *See* Tex. Est. Code § 201.003; *Burton v. Bell*, 380 S.W.2d 561, 565 (Tex. 1964). As a result, the surviving spouse's half-interest in the community vests immediately. *See* Tex. Est. Code §§

101.001, 101.003, 101.051, 201.003. The treatment of debts upon death cannot be easily summarized. Paulsen, 63 Baylor L. Rev. at 788-89. The Texas Estates Code provides that "the community estate" of the deceased spouse "passes charged with the debts against it." *See* Tex. Est. Code § 201.003. "Read literally and in isolation, this language would limit unsecured creditors of the dead spouse only to the decedent's half of 'the community estate'—that is, the entire community estate, not just the two community property management categories available to creditors during life." Paulsen, 63 Baylor L. Rev. at 789. "Depending on the particular family's circumstances, an unsecured creditor might fare better or worse after the debtor spouse's death." *Id*. Professor Paulsen has described these differences as follows:

> For example, assuming only the husband worked outside the home and could prove all community property traced to those earnings, the husband's contract creditors could reach all community property during life. However, assuming that only the husband's one-half ownership interest passes subject to those debts, such a creditor would lose half of all property that would have been available to satisfy a judgment secured during his life. Conversely, a creditor with an unsecured debt against the wife could not have reached any community property during life (because it is all the husband's sole-management property in this scenario), but could reach one-half of that property at the wife's death.

Paulsen, 63 Baylor L. Rev. 789, n.46, 849.

Section 101.052 of the Estates Code governs the liability of community property for debts of a deceased spouse. It provides:

> (a) The community property subject to the sole or joint management, control, and disposition of a spouse during marriage continues to be subject to the liabilities of that spouse on death.
>
> (b) The interest that the deceased spouse owned in any other nonexempt community property passes to the deceased spouse's heirs or devisees charged with the debts that were enforceable against the deceased spouse before death.
>
> (c) This section does not prohibit the administration of community property under other provisions of this title relating to the administration of an estate.

Tex. Est. Code Ann. § 101.052.

While Section 101.052 mimics the Family Code's management categories, it does alter the Family Code's liability scheme to some extent. *Compare* Tex. Fam. Code §§ 3.102 and 3.202, *with* Tex. Est. Code Ann. § 101.052. Professor Paulsen has summarized them as follows:

> Depending on the particular circumstances, an unsecured creditor might have significantly more--or less-- property available to satisfy a judgment after death than during the debtor's lifetime.
>
> Again, examples might help. Assume the husband is sole signer on an unsecured car loan. During the husband's married life, the lender can reach all his sole-management and joint-management community property, but not his wife's sole-management community property. After the husband dies, creditors still can reach his former sole-management community property, as well as all joint-management community property. However, Section [101.052] also says the husband's half-interest in "any other nonexempt community property"—that is, the wife's former sole-management community property--is now subject to the contract debt, even though that half-interest would not have been at risk during the husband's life.
>
> This reading of the statute has been questioned by able commentators. Nonetheless, the result just described seems to be what the legislature intended.
>
> By contrast, the Texas [Estates] Code may significantly disadvantage a tort creditor. Assume the husband dies from injuries received in an auto accident in which he ultimately is judged at fault. Had he lived, the creditor could have seized all non-exempt community property, however categorized. Because he died, though, Section [101.052] shields half the wife's former sole-management community property from her husband's tort liability.

Paulsen, 63 Baylor L. Rev. at 790-92 (internal citations omitted).

B. Divorce

What a divorce court is supposed to do in relation to the spouses' debts upon divorce, under Texas' system of community property, coupled with its unique system for divided management and liability of marital property, is not an easily answered question because the Texas Family Code remains largely silent on the matter, unlike the Estates Code with respect to a decedent's debts.

Section 7.001 provides that a divorce court must "order a division of the estate of the parties in a manner that the court deems just and right, having due regard for the rights of each party and any children of the marriage." *See* Tex. Fam. Code § 7.001.

Section 7.001, and its predecessor statute, former section 3.63, have been interpreted numerous times, and the phrase "estate of the parties" has been interpreted to mean that the divorce court is authorized to divide the parties' "community property" and cannot divest either spouse of their separate property. *Pearson v. Fillingim*, 332 S.W.3d 361, 362 (Tex. 2011)(interpreting Section 7.001); *Cameron v. Cameron*, 641 S.W.2d 210, 214 (Tex. 1982)(interpreting former section 3.63).

The Texas Supreme Court's interpretation of the phrase "estate of the parties" comports with customary definitions of the term "estate." Black's Law Dictionary defines "estate" as "[t]he amount, degree, nature, and quality of a person's interest in land or other property." ESTATE, Black's Law Dictionary (10th ed. 2014). In addition, the Court's definition comports with the Estate's Code definition of a decedent's estate, which states:

> "Estate" means a decedent's property, as that property:
> (1) exists originally and as the property changes in form by sale, reinvestment, or otherwise;
> (2) is augmented by any accretions and other additions to the property, including any property to be distributed to the decedent's representative by the trustee of a trust that terminates on the decedent's death, and substitutions for the property; and
> (3) is diminished by any decreases in or distributions from the property.

Tex. Est. Code Ann. § 22.012.

Thus, the Texas Supreme Court's, and the Texas Legislature's, definition of the word "estate" focuses on property, not debt. Moreover, in the circumstances of death, the Texas Legislature has definitely stated that "[t]he interest that the deceased spouse owned in any other nonexempt community property passes to the deceased spouse's heirs or devisees charged with the debts that were enforceable against the deceased spouse before death." *See* Tex. Est. Code § 101.052(b). Family lawyers will not find a similar statute, in the Family code, addressing what happens to debt at the time of divorce.

It also bears remembering that, under Texas law, an estate is not a legal entity and therefore cannot own property or incur debt. *See Henson v. Estate of Crow*, 734 S.W.2d 648, 649 (Tex.1987)(decedent's estate is not a legal entity); *Republic Bankers Life Ins. Co. v. Bunnell*, 478 S.W.2d 800, 801 (Tex.Civ.App.—Austin 1972, no writ)(same); Tom Featherston, Marital Property Liability: Post Tedder, Texas Family Law Section, Section Report, p.12 (September 2017)(noting that the community estate of spouses is not a legal entity which can own property or incur debt). Thus, only spouses can own property and incur debt. While this point is helpful in determining who ultimately owns property and who is liable for debt, it does not help in understanding what relation the parties' debts have to a trial court's "just and right" division at the time of divorce.

It is also worth noting that the Family Code also permits divorcing couples to divide their property by agreement, with such agreement binding the court, unless it finds the terms are not "just and right." *See* Tex. Fam. Code § 7.006(b). However, the code, again, says little about what a divorce court is supposed to do with the spouses' debts, let alone what rights creditors have upon divorce. As a result, family law practitioners and courts must turn to case law to try to divine what a divorce court is supposed to do with the spouses' debt when making a "just and right" division.

1. <u>What a Court Can Do</u>

When making a "just and right" division of community property, the trial court, in exercising its discretion, is instructed to consider many factors including the parties' earning capacities, abilities, education, business opportunities, physical condition, financial condition, age, size of separate estates, nature of the property, and the benefits which the spouse, who did not cause the breakup of the marriage, would have enjoyed had the marriage continued. *Murff v. Murff*, 615 S.W.2d 696, 699 (Tex.1981). In a more pointed statement it has been said that the trial court must consider: "all the equities, the nature of the property, the debts secured by liens on property awarded to each, the liabilities, and the ability of the parties to manage the property that is encumbered in order that the property will not be lost to both spouses by foreclosure." *Walker v. Walker*, 527 S.W.2d 200, 203 (Tex.Civ.App.—Fort Worth 1975, no writ).

Practitioners and courts will find any number of cases instructing the divorce court that it should take the parties' debt into account when dividing the parties' community property. *See, e.g., Walston v. Walston*, 971 S.W.2d 687, 693–94 (Tex.App.—Waco 1998, pet. denied) (the parties "debts and liabilities are part of the community estate which must be considered by the trial judge in making a "just and right" division of their community property); *Vannerson v. Vannerson*, 857 S.W.2d 659, 673 (Tex. App.—Houston [1st Dist.] 1993, pet. denied) ("The parties' liabilities are

factors to be considered in making a just and right division."); *Finn v. Finn*, 658 S.W.2d 735, 748 (Tex.App.—Dallas 1983, writ ref'd n.r.e.) (The parties' liabilities are factors to be considered in making a just and right division.).

Likewise, practitioners and courts will find any number of cases instructing the divorce court that it has the authority to make a "division" of the parties' debt, by ordering the payment or disposition of the debts, as between the divorcing parties, that require one spouse to pay the other's debts, or to assume full responsibility for a debt jointly incurred. *See e.g., Blake v. Amoco Fed. Credit Union*, 900 S.W.2d 108, 112 (Tex. App.—Houston [14th Dist.] 1995, no writ) (stating that a court can "provide that one spouse should pay the debt of the other" but that "the divorce court could not prejudice the creditor's right to take a judgment against both spouses when dividing responsibility for payment of debts"); *Vannerson*, 857 S.W.2d at 673 ("A divorce court has authority and discretion to impose the entire tax liability of the parties on one spouse."); *Taylor v. Taylor*, 680 S.W.2d 645, 648 (Tex. App.—Beaumont 1984, writ ref'd n.r.e.) ("The trial court, in making a division of the community estate... has authority to order the payment or disposition of the community debts.").

While at least one case suggests that a court awarding one spouse the vast majority debt and virtually no assets may be reversible error, *see Welch v. Welch*, 694 S.W.2d 374 (Tex.App.—Houston [14th Dist] 1985, no writ), the court's discretion in dealing with debt is broad and it is clear that the court can make one spouse responsible for the majority of the parties' debts. *Coggin v Coggin*, 738 S.W.2d 375 (Tex. App.—Corpus Christi 1987, no writ).

Understand also that the court can award one party the debt for an asset such as an automobile while awarding the asset to their spouse. *See Coggin*, Supra. In that instance, see the drafting advice, below, in this article to address this issue.

2. What the Court or Parties Cannot Do

First, it is generally stated that a divorce court cannot alter a creditor's substantive rights. *See, e.g., Shelton v. Shelton*, No. 01-02-01009-CV, 2003 Tex. App. LEXIS 9466, at *7 (Tex. App.—Houston [1st Dist.] Nov. 6, 2003, no pet.) (mem. op.) ("a trial court, in dividing a community estate, may not disturb or prejudice the rights of a third-party creditor to collect from either of the divorcing parties on a joint obligation"); *Broadway Drug Store of Galveston, Inc. v. Trowbridge*, 435 S.W.2d 268, 269-70 (Tex. Civ. App.—Houston [14th Dist.] 1968, no writ) ("[t]he court in a divorce action has no power to disturb the rights which creditors lawfully have against the parties") *Swinford v. Allied Fin. Co.*, 424 S.W.2d 298, 301 (Tex. Civ. App.—Dallas 1968, writ dism'd)(same); Paulsen, 63 Baylor L. Rev. at 793, n. 69. However, the ability of a divorce court to alter unsecured creditor's rights through its decree will be explored in more detail, below.

Next, a secured creditor's interest in a particular item of property is obviously not affected by divorce since that type of creditor holds an instrument granting it a lien on specified property which remains unaffected by the divorce. *See, e.g., Mussina v. Morton*, 657 S.W.2d 871, 873 (Tex. App.—Houston [1st Dist.] 1983, no writ) (holding that absent a valid dispute over the lien or default, a family law court must let a bank commence foreclosure proceedings); *Glasscock v. Citizens Nat'l Bank*, 553 S.W.2d 411, 413 (Tex. Civ. App.—Tyler 1977, writ ref'd n.r.e.) (stating that "the court in a divorce action has no power to disturb the rights which creditors lawfully have against the parties or to award the property to the creditor's prejudice"); Paulsen, 63 Baylor L. Rev. at 793, n. 70.

Furthermore, an unsecured creditor's rights against the spouses on a joint obligation is not extinguished just because the divorce court assigns sole responsibility for repayment to the other spouse. *See, e.g., Blake*, 900 S.W.2d at 111 ("It is well-settled law in Texas that divorce courts cannot disturb the rights of a creditor to collect from either of the divorcing parties on a joint obligation."); *see also* Paulsen, 63 Baylor L. Rev. at 793, n. 71.

3. How Does the Demise of the Community Debt Myth Impact the Foregoing Rules?

Even though the concept of "community debt" has died, a thorny issue still remains with regard to the "just and right" division of the spouses' debt upon divorce. Practitioners and courts will find any number of cases instructing the divorce court that it has the authority to make a "division" of the parties' "community debts." *See e.g., Taylor v. Taylor*, 680 S.W.2d 645, 648 (Tex. App.—Beaumont 1984, writ ref'd n.r.e.) ("The trial court, in making a division of the community estate... has authority to order the payment or disposition of the community debts."). Similarly, practitioners and courts will find a line of cases holding that a divorce court has no authority to order one spouse to pay the other spouse's separate debts. *See e.g., Love v. Bailey-Love*, 217 S.W.3d 33, 35 (Tex.App.—Houston [1st Dist.] 2006, no pet.)("The obligation to pay the [student] loans arose before marriage and should be treated as Sophia's separate debt—separate debt that could not be assigned to the non-incurring spouse.").

So, what are practitioners and courts supposed to do with the foregoing statements of law? Do they still stand? Do they need to be refined? If so, how should they be refined? What debts can the divorce court consider when making a "just and right" division of community property? Is the court restricted to joint liability debts of the spouses only? What about sole liability debts of each spouse? Should a distinction be drawn between debts incurred before or during marriage? What if the liabilities are for necessaries or are for the maintenance or acquisition of community property? What if the liabilities are for acquisition or maintenance of separate property?

Perhaps an example would help focus the issue. In *Bush v. Bush*, the trial court ordered husband's separate property business to take out a loan to pay unpaid payroll taxes during the pendency of the case in order to avoid IRS foreclosure on certain community property. *Bush v. Bush*, 336 S.W.3d 722, 738-39 (Tex.App.—Houston [1st Dist.] 2010, no pet.). At trial, it was undisputed that during the marriage wife participated in the business as an office manager and that the parties lived on the income from husband's separate property business and filed joint federal income tax returns. *Id*. The parties tax returns showed that the business operated at a loss for some of the years in question. *Id*. at 740. Wife testified, however, that husband regularly took money from the business that was never reported and that the tax returns did not accurately reflect the income of the business. *Id*. at 740-41. She also testified that, if she needed cash, she would call husband to get permission to take cash from the company account. *Id*. at 741. Wife also regularly wrote checks from the company's checking account for matters not related to the business. *Id*. Ultimately, the trial court determined that the debt was a "liabilit[y] of the community estate [and was] considered by the trial court in determining a just and right division." *Id*. at 739. On appeal, wife argued that the unpaid payroll taxes incurred by husband's separate property business, was a debt incurred by husband's separate property and that the trial court erred by considering the tax obligations in its division of the community estate. *Id*. at 738.

The court of appeals affirmed, concluding that the trial court could reasonably have determined from the evidence that income from husband's separate property business was property of the community estate, that that income was increased and the community estate was benefitted by the business' failure to pay its federal employment taxes, and that the loan taken out by husband to pay off his business' employment tax burden could, therefore, properly be apportioned to the parties jointly. *Id*. at 740-41. In making its determination, the court of appeals said the following with respect to each parties' attempt to invoke the Family Code's marital liability provisions when arguing why or why not the employment tax liability should or should not have been considered when the trial court made its "just and right" division:

> In their briefs, both parties focus on whether [wife] could or should have been personally liable for the employment tax obligation to establish whether the payroll tax obligation should have been considered in the division of the community estate. [Wife] cites to section 3.201 of the Family Code in support of her argument that she could not be held liable for the debt and, accordingly, the debt could not be considered in dividing the community estate. *See* TEX. FAM.CODE ANN. § 3.201 (Vernon 2006). Section 3.201 provides that a person is liable for acts of a spouse if the spouse acted as an agent for that person or incurred debt for necessaries and that "[e]xcept as provided by this subchapter, community property is not subject to a liability that arises from an act of a spouse." *Id*. at § 3.201(a)(1), (b). [Husband] argues that, because [wife] participated in the management of the business, the trial court was correct to determine that the tax obligation was a community liability.
>
> Both [wife's] and [husband's] arguments address the manner of determining liability of spouses to third-party creditors instead of the manner of determining whether certain debts and liabilities of the spouses are liabilities of the community and can therefore be considered in dividing the community estate. When a third-party creditor attempts to collect on a debt, liability to the creditor is not assessed against the community estate or the separate estates of the spouses. Instead, it is assessed against one or both of the parties to the marriage in their individual capacity. *See Nelson v. Citizens Bank and Trust Co. of Baytown*, Tex., 881 S.W.2d 128, 131 (Tex.App.—Houston [1st Dist.] 1994, no writ) (holding contractual liability of one spouse allows creditor to reach that spouse's share of community property but does not make other spouse personally liable). Section 3.201 addresses when the acts of one spouse attach to the other spouse for purposes of liability to a third-party creditor. TEX. FAM.CODE ANN. § 3.201. Section 3.202 addresses what portions of the assets of the spouses can be reached by a third-party creditor after liability has been assessed against one or both of the spouses. TEX. FAM.CODE ANN. § 3.202 (Vernon Supp. 2010). Neither of these statutes addresses what debt can be considered as a debt of the community in creating a just and right division of the community estate.

> During the trial, the trial court stated to the parties, "[W]hether [wife] was liable for [the taxes] ... is not going to change the character of whether it was or was not a community debt. Whether they're going to look to her individually once this is all said and done, doesn't transform it from community to a separate debt." We agree with the trial court. Whether a spouse is liable to a third-party creditor for the debt of the other spouse is a separate analysis from determining whether certain debts and liabilities of the spouses can be considered in dividing the community estate. *See Inwood Nat'l Bank of Dallas v. Hoppe*, 596 S.W.2d 183, 185 (Tex.Civ.App.—Texarkana 1980, writ ref'd n.r.e.)(holding characterization and division of property in divorce have no effect on third-party creditor's rights); *Providian Nat'l Bank v. Ebarb*, 180 S.W.3d 898, 902 (Tex.App.—Beaumont 2005, no pet.)(holding determining debt to be community liability does not affect whether one spouse is liable to creditor for debt incurred by other spouse).

Bush, 336 S.W.3d at 739–40.

The court of appeals is correct about one thing. The analysis about what debts a trial court should consider when making a "just and right" division is different from the analysis regarding whether a spouse is liable jointly or solely for a debt, and what property a creditor may seize to pay the debt. Unfortunately, the court of appeals analysis relies too heavily upon the discredited concept of "community debt." However, in the court of appeals' defense, neither the Family Code, nor Texas Supreme Court decisions, are particularly enlightening on what debts can or cannot be considered by the trial court in making a just and right division. Nevertheless, by injecting a faulty characterization analysis of the parties' debt into its analysis about whether the trial court made a "just and right" division of the parties' community property, the court of appeals adds an unnecessary layer of analysis which ultimately confuses the central issue—whether the division of community property was "just and right."

In *Bush*, wife complained that it was unfair for the trial court to consider the debt the court ordered husband to take out to pay unpaid payroll taxes for his sole proprietorship. *Supra*, 738-39. Her argument was that the trial court should have ignored that debt when valuing and dividing the community estate because the debt benefitted husband's separate property business. However, had the payroll taxes been paid timely during the marriage, the income from the business would have been reduced and the parties would have had less money to spend during the marriage. There clearly was a connection between the payroll taxes and the income the parties consumed during marriage. Wife's allusion to the character of the husband's business and the alleged character of the debt used to benefit that business only served to confuse the issues and distract from the main issue: why the trial court should or should not consider a debt of one of the spouses when dividing the estate.

The division of a community estate in divorce must be "just and right, having due regard for the rights of each party and any children of the marriage." *See* Tex. Fam. Code § 7.001. "Just" and "right" are broad terms. *Bradshaw v. Bradshaw*, No. 16-0328, 2018 WL 3207131, at *2 (Tex. June 29, 2018)(Hecht, C.J., plurality opinion). Black's Law Dictionary defines "just" as "[l]egally right; lawful; equitable", and "right" as "[t]hat which is proper under law, morality, or ethics". *Id*. And "due regard" simply means the "[a]ttention, care, or consideration" that is "[j]ust, proper, regular, and reasonable". *Id*. The Supreme Court's decision in *Murff* instructs a trial court to consider, among other things, "the parties' . . . business opportunities . . . financial condition . . . nature of the property, and the benefits which the spouse, who did not cause the breakup of the marriage, would have enjoyed had the marriage continued," when making a "just and right" division. *Murff*, 615 S.W.2d at 699. However, the Court also instructs the trial court to consider the "size of separate estates" of the parties. *Id*. The court may consider the "fault in breaking up the marriage", though the community-property division "should not be a punishment for the spouse at fault." *Bradshaw*, No. 16-0328, 2018 WL 3207131, at *2. In the end, "the court is to do complete equity as between the husband and wife and the children, having due regard to all obligations of the spouses and to the probable future necessities of all concerned." *Id*.

It seems obvious that debts acquired during marriage for living expenses and to pursue the acquisition of community property should be considered in the "just and right" division, but whether this includes all debts incurred by the spouses before or during marriage remains unclear until the issue is definitively addressed by the Texas Supreme Court or the Texas Legislature. The best answer, for now, is that the trial court is instructed to make a "just and right" division of the parties' community property, "having due regard for the rights of each party and any children of the marriage," and any argument regarding why a particular debt should or should not be considered in the division should focus on why it is equitable or inequitable to consider the debt in dividing the parties' community property. *See* Tex. Fam. Code § 7.001.

In addition, when arguing about whether one party should be ordered to pay a debt of another party, careful attention must be paid as to whether the party ordered to pay a debt is legally obligated to pay the debt. This is where Family Code Sections 3.101, 3.102, 3.201, and 3.202, become the guiding rules for the trial court. It is risky for a trial court to order one spouse to pay the other spouse's sole liability debt, especially when that debt was incurred before marriage, because Section 3.201 is quite clear that a spouse is not liable to pay such a debt. *See* Tex. Fam Code § 3.201. The only legal basis for ordering such a thing to occur would be Section 7.001 "just and right" division powers. But it is questionable whether a trial court can order a party to pay a debt that they do not owe, pursuant to a statute that authorizes the trial court to divide property, since the thing being divided is not property, but is debt. There is also the practical problem of the party who is ordered to pay the other spouse's sole liability debt not paying it and there being no ability to enforce the non-payment by contempt. Thus, it is generally risky for a party to request, and for a trial court to order, that one spouse pay the sole liability debt of the other party especially when that debt was incurred before marriage. *See e.g., Love*, 217 S.W.3d at 35 (holding that it was improper for the trial court to order one spouse to pay the other spouse's student loans which were incurred prior to marriage).

VI. UNSECURED CREDITOR'S RIGHTS AFTER DIVORCE

Professor Paulsen has posed a simple question to Texas courts and practitioners:

> Can the unsecured creditor of one Texas spouse reach community property awarded to the other spouse at divorce? The question is simple, and the answer can be important to divorcing couples and their creditors. Unfortunately, Texas law provides no clear answer. The Supreme Court of Texas has not spoken directly to the point for more than a century. During that time, marital property law and the rights of married women have changed radically. Nonetheless, most Texas courts and commentators still assume an unsecured creditor can reach any property after divorce the creditor could have reached before divorce, even if the property has been awarded to the non-liable spouse by agreement or court order.

Paulsen, 63 Baylor L. Rev. at 782. However, as Professor Paulsen explains in his paper, "The Unsecured Texas Creditor's Post-Divorce Claim to Former Community Property," the assumption that an unsecured creditor can reach the same property after divorce the creditor could have reached before divorce needs to be rejected in the same manner that Texas law has finally rejected the "community debt" myth.

A. The Birth of a Myth.

The myth that an unsecured creditor can reach the same property after divorce the creditor could have reached before divorce comes from the Texas Supreme Court's decision in *Richey v. Hare*, 41 Tex. 336, 336-41 (Tex. 1874). In *Richey*, a creditor secured a judgment against a debtor along with a writ of execution which was levied upon land owned by the debtor. *Richey*, 41 Tex. at 339. The same day, probably later in the day, the debtor and his wife divorced. The debtor and his wife presented, and the judge approved as part of the divorce decree, their agreement to sell some land held in the debtor's name, the proceeds to be divided between the divorcing couple. *Id*., at 338. The divorce decree described the land as community property homestead. *Id*. The creditor, who was looking to the land to satisfy the judgment, agreed with the community property description, but took issue with the homestead assertion. *Id*. at 338-39, 341. Five weeks later, the property at issue was sold on the courthouse steps--twice. *Id*. at 339. The sheriff first sold the disputed land to the creditor, with proceeds applied against the judgment. *Id*. Next, commissioners appointed by the trial court then sold the same land to a third party and divided the proceeds between the debtors, as provided in the divorce decree. *Id*. The third-party purchaser was aware of the first sale when he bought the property. *Id*. A trespass to try title suit between pre-divorce creditor and post-divorce purchaser followed. *Id*. The trial court ruled for the post-divorce purchaser; the Supreme Court of Texas sided with the pre-divorce creditor. *Id*. at 338-41.

Richey was not a hard case to decide. The pre-divorce creditor's judgment, writ of execution, an dlevy upon the land created a lien on the property thereby securing the creditor's interest in any sales proceeds from the sale of the property. *Drake Interiors, LLC v Thomas*, 433 S.W.3d 841, 847-49 (Tex. App.—Houston [14th Dist.] 2014, pet. denied)(noting that a judgment lien is created by filing and indexing an abstract of judgment and the lien attaches to a homestead once the homestead exemption is lost or abandoned). Further, *Richey* reeks of fraud by the debtors. Thus, the Texas Supreme Court did get it right when they ruled in favor of the pre-divorce creditor. However, *Richey* is not remembered for how the Court ruled on the facts, but for what it said the law was in reaching its decision.

The Supreme Court's opinion stated that "[t]he division of property between the husband and wife . . . must be done in subordination to the rights of creditors having claims on the community property, and which may be liable for debts." *Id*. at 340-41. The *Richey* court's expansive language describing the "subordination" of a divorce court's

property division order to the "rights" of creditors with "claims" on community property that "may be liable" for debts was isolated and included in Ocie Speer's influential twentieth-century treatise, Marital Rights in Texas, without the narrower factual context that drove the court's true holding--a creditor's claim already reduced to a judgment lien--was not emphasized. Paulsen, 63 Baylor L. Rev. at 797-98. Speer's treatise would influence a couple of generations of lawyers and courts to such a degree that the belief that an unsecured creditor can reach the same property after divorce the creditor could have reached before divorce became legal dogma with few practitioners, courts, or legal authorities ever tracing the rule back to its source of origin or re-examining it in light of significant changes in law over the years. And that is how the myth was born and took root in Texas practice.

The Texas Supreme Court came close to revisiting the issue of unsecured creditor's rights after divorce in *Stewart Title Co. v. Huddleston*, 598 S.W.2d 321, 323 (Tex.Civ.App.—San Antonio 1980), *writ refused n.r.e.*, 608 S.W.2d 611 (Tex. 1980)(holding that ex-wife's one-half interest in real property which had been part of community estate could not be subjected to liens resulting from judgments against ex-husband based on "community debts" where judgment was recovered after community estate was divided and ex-wife was not made a party to the post-divorce suit*); see also, Rancho Mi Hacienda v. Bryant*, 365 S.W.3d 127, 130 (Tex.App.—Texarakana 2012, no pet.)(holding that community property awarded to one spouse in a divorce is not liable to pay a post-divorce judgment recovered solely against the other spouse absent a judgment imposing liability on the non-judgment debtor spouse). However, the rationale for the Supreme Court's decision in *Stewart Title* was less than clear and raised more question on the subject of unsecured creditor's rights after divorce than it answered. Paulsen, 63 Baylor L. Rev. at 803-10.

Today, a majority of the state's courts of appeals have relied upon the dicta in the Texas Supreme Court's decision, in *Richey*, to hold that unsecured creditors can reach the same assets after divorce as those creditors could reach beforehand. *See* Paulsen, 63 Baylor L. Rev. at 794, n. 73-78 (discussing Texas law and the courts of appeals dubious reliance on old dicta from *Richey v. Hare*).

B. Why the Myth Needs to Die.

The myth that unsecured creditors can reach the same assets after divorce as those creditors could reach beforehand needs to die because *Richey* was decided before coverture ended, before enactment of the family code, before the concept of "community debt" was abolished by the family code, and before the 1980 amendment to the Texas Constitution—an amendment which was intended to eliminate the special status of unsecured creditors with regard to agreements between spouses as to disposition of their marital property. Paulsen, 63 Baylor L. Rev. at 794-849; *see also*, Tex. Fam. Code §§ 3.201 and 3.202 and *Tedder*, 421 S.W.3d at 655 (holding that there is no such thing as "community debt" apart from a debt transaction in which community credit is used to purchase an asset, and holding that a person is only liable for the debts of their spouse as provided by Chapter 3, Subchapter C, of the Texas Family Code).

The Texas Constitution has been amended several times to address marital property management and liability issues. Prior to 1948, the Texas Constitution provided that "laws shall be passed more clearly defining the rights of the spouses, in relation to separate and community property." Tex. Const. art. XVI, §15. In 1948, an amendment to Section 15 stated, in part: "provided that husband and wife, without prejudice to pre-existing creditors, may from time to time … partition" their community property. *Id.* Tex. H.R.J. Res. 13, §1, 50th Leg., R.S. (1947).

In light of this language from the 1948 amendment ("without prejudice to pre-existing creditors"), it could be argued that the amendment extended the rights of unsecured creditors post-divorce and/or post-partition. However, in 1980, the voters approved a further constitutional amendment that, among other changes, modified the language just quoted. The Texas Constitution now says that "persons about to marry and spouses, without the intention to defraud pre-existing creditors, may … partition" their community property. Tex. Const. art. XVI, §15; *see also* Richard G. Moore, Comment, The 1980 Texas Marital Property Amendment: An Analysis of Its Meaning and Effect, 33 Baylor L. Rev. 307 (1981).

By changing the constitutional language from "without prejudice" to "without the intention to defraud," state legislators and voters repudiated the concept of favoring unsecured creditors at divorce. The principal drafter of the 1980 amendment published comments regarding the amendment and noted as follows:

> The 1948 amendment to the Texas Constitution provided that spouses might partition their community property "without prejudice to pre-existing creditors." This provision gives pre-existing creditors an unwarranted special advantage over the nondebtor spouse that is not given to pre-existing creditors in cases of interspousal gifts … Under present law, for example, a husband's pre-existing creditors may levy execution on community property … even though the partition did not cause the husband to become

> insolvent, and even though the husband was ordered to pay the creditor …. Under the proposed amendment the creditor's position would be the same whether the spouses make a partition or enter into some other type of transaction.

See Joseph W. McKnight & Robert Edwin Davis, For Amendment No. 9, Tex. B.J., Oct. 1980, at 925.

The drafters of the 1980 constitutional amendment intended and expected that the new language would define the outer limits of an unsecured creditor's post-divorce rights. Paulsen, 63 Baylor L. Rev. at 824, n. 256 (citing and quoting Professor McKnight). "Unfortunately, that aspect of the amendment is seldom discussed, perhaps because the creditor-limiting language may have been obscured by more prominent features, such as provisions that authorized effective pre-marital agreements and resolved probate issues." Paulsen, 63 Baylor L. Rev. at 825. However, "[e]ver since the 1980 amendment, special treatment for unsecured creditors at divorce cannot be squared with the fundamental public policy expressed by the modern Texas Constitution." *Id*. at 825.

"Long before the 1980 amendment, the notion that unsecured creditors had some sort of inchoate equity that survived a divorce decree created anomalies." Paulsen, 63 Baylor L. Rev. at 825. "For example, as the amendment's drafters pointed out, a Texas debtor always has been able to reduce the amount of community property available to satisfy a creditor's demands by making a gift to her spouse, or to a third party." *Id*. "Though the gift may reduce the amount of property that is available to satisfy the demands of an unsecured creditor, the transfer still is valid unless the creditor can prove fraud or resulting insolvency." *Id*.; *see also, Blanton v. Cain*, 290 S.W. 795, 797 (Tex.Civ.App.—Galveston 1927, no writ)(holding that a solvent spouse may transfer his or her interest in the spouses' community property to the other spouse, and such a transfer is not fraudulent as to the transferring spouse's creditors).

"After the 1980 amendment, persons about to marry or spouses have even more freedom to reduce or eliminate the amount of community property that otherwise would be available to satisfy creditors." Paulsen, 63 Baylor L. Rev. at 826. "To reiterate, the Texas Constitution authorizes pre- and post-marital agreements unless made 'with the intention to defraud pre-existing creditors.'" *Id*. "Implementing legislation mirrors this language, specifying that a spousal agreement is 'void with respect to the rights of a preexisting creditor whose rights are intended to be defrauded by it.'" *Id*. (citing Tex. Fam. Code § 4.106(a)). "The Family Code provisions regulating premarital agreements and agreements incident to divorce do not specifically mention creditor rights, though no implications are warranted from those omissions." Paulsen, 63 Baylor L. Rev. at 826.

"In sum, an unsecured creditor can avoid the effect of a married person's gifts and property-management agreements only by proving the equivalent of actual fraud, or by showing the spouse did not receive equivalent value and was rendered insolvent by the transfer." *Id*. at 826-27. "A creditor's rights are even more restricted in relation to ordinary premarital and marital agreements--only proof of actual fraud will do." *Id*. at 827. "Parties also can divide their property by agreement at divorce, subject only to the trial court's oversight and potential veto." *Id*. (citing Tex. Fam. Code § 7.006(c)).

Given the foregoing, "[i]t simply is not reasonable to assume an unsecured Texas creditor, in the post-1980 world, has rights superior to a judge's broad-ranging "just and right" division powers; were that so, one would expect the legislature to spell out such an exception, just as the legislature has done in the Texas [Estates] Code." *Id*. "[I]f the public policy concern is potential fraud on creditors, as the 1980 constitutional amendment makes clear, it is hard to imagine a situation with less potential for fraud than a divorce agreement subject to judicial oversight, or a court order entered after a contested hearing." *Id*. "Either way, a judge has approved the agreement as "just and right," presumably taking legitimate concerns of creditors into account." *Id*.

Next, the notion that the unsecured creditor of one spouse can reach property in the hands of an innocent spouse after divorce is not only inconsistent with the Texas Constitution, but it is also inconsistent with Texas statutory law. This is so because the statutes which allow a creditor to seize community property to pay their debts are not operative after divorce, since divorce ends the community estate, and there is no longer any community property for a creditor to seize. Paulsen, 63 Baylor L. Rev. at 829-34; Tex. Fam. Code § 3.202 (setting forth the rules of "marital property liability"); *see also* Tex. Const. art. XVI, §15 (discussing character only in relation to persons who are about to marry and spouses); *Workings*, 700 S.W.2d at 253 ("At the time of the first divorce, the community property held by the parties either became their separate property according to the terms of the purported property agreement, or, if there was no agreement, they became tenants-in-common of undivided separate property"); *Ambrose*, 90 P. at 589 ("Where no disposition of the property rights of the parties is made by the divorce court, the separate property of the husband prior to the divorce becomes his individual property after divorce, the separate property of the wife becomes her individual property, and, from the necessities of the case, their joint or community property must become common property. After the divorce there is no community, and in the nature of things there can be no community property.").

"The world has changed since the Texas doctrine granting favored treatment to unsecured creditors at divorce first was announced." Paulsen, 63 Baylor L. Rev. at 835. "It is difficult to imagine what equities might still justify a rule that deviates from modern rules of commerce to specially favor unsecured creditors in their dealings with married persons in the absence of a common-law lien or statutory right." *Id*. "To the contrary, any creditor should know that a potential debtor might be married and that divorce is common." *Id*. "A savvy creditor also should know that the property that seems available to satisfy a judgment when a loan is made might be affected by any number of later events--such as a voluntary sale, another creditor's lien or judgment, [a gift,] or even a spousal agreement that can be set aside only by proving fraud." *Id.*

"While rules of coverture once prohibited a married woman from freely contracting debts, the unsecured contract creditor of one spouse now occupies that position only by choice." Paulsen, 63 Baylor L. Rev. at 836. "If a loan benefits both spouses, or if the creditor has some other legitimate reason to require that both spouses assume personal liability, the creditor can insist that both spouses sign." *Id*. "If the creditor intends to rely on the availability of any particular item of property for payment, the creditor can take and properly perfect a security interest." *Id*. "In sum, '[f]uture creditors of the spouses, at least their voluntary or contractual creditors, have an extraordinary ability to self-protect that weighs against giving them additional special protection.'" *Id.*

Moreover, "one should keep in mind that an unsecured creditor loses no legal right if formerly available community property is awarded to the non-debtor spouse at divorce." Paulsen, 63 Baylor L. Rev. at 841. "An unsecured creditor always assumes some risk." *Id*. "The debtor spouse might give or gamble property away, lose it in bad investments, or pay it out in medical bills." *Id*. "Divorce does not affect an unsecured creditor's substantive rights." *Id*. "It is just another contingency." *Id*. "'The creditor still has the same rights that the creditor had during the marriage, only the quantity of property available for the creditor has changed.'" *Id*. "In fact, a Texas unsecured creditor does not always lose ground even in the quantum of property available to satisfy a debt after divorce." *Id*. "To the contrary, even without special rules, an unsecured creditor may wind up in a more favorable position after divorce than before." *Id*. "This anomaly stems from the fact that the Texas divided-management system operates independently from the trial court's power to divide the entire mass of community property at divorce." *Id*. As Professor Paulsen explains:

> Assume, for example, that the debtor spouse does not work outside the home, and that the non-debtor keeps all earnings in segregated accounts totaling $1,000,000. One day before divorce, the debtor spouse's unsecured contract creditor could not reach one penny of that $1,000,000, it being the non-debtor's sole-management community property. But once the trial court makes an equal division of the community in the exercise of its "just and right" powers, the debtor ex-spouse suddenly has $500,000 available to satisfy the creditor's demands.
>
> There is, in this writer's view, nothing inherently wrong with this result. Divorce does not affect the creditor's right to take a personal judgment against the debtor ex-spouse. Because there is no community property after divorce, the statute governing creditor rights no longer shields the non-debtor spouse's former sole-management community property. The divorce court's power is not circumvented; indeed, in an appropriate case, the judge might even have ordered a disproportionate division of the community assets to assure the debtor spouse would have enough money to pay personal creditors and get on with life.

Paulsen, 63 Baylor L. Rev. at 841-42.

In summary, it is time for the myth, that the unsecured creditor of one spouse can reach property in the hands of an innocent spouse after divorce, be put to rest and replaced with the standard voters and legislators agreed upon in 1980—an unsecured creditor's ability to reach community property may be impaired by written agreement of the spouses, or court order, so long as the agreement or order is not made "with the intention to defraud pre-existing creditors." Tex. Const. art. XVI, §15.

VII. FRAUDULENT TRANSFERS AND BANKRUPTCY

While this article cannot begin to cover the scope of fraudulent transfers or bankruptcy, each topic being broad enough to warrant an article of its own, a few words of caution are in order with regard to these subjects.

It cannot be stressed enough, that Family Code Sections 3.101, 3.102, 3.201, and 3.202 are of paramount importance when sorting through creditor's rights, spousal liability, and the liability of marital property for a creditor's claims.

For example, to determine the extent to which a Texas taxpayer spouse has an interest in marital property that may be seized to pay a tax delinquency, federal courts consult Texas state law. *Medaris v. United States*, 884 F.2d

832, 833 (5th Cir. 1989)(looking to former section 5.61, now Section 3.202, and holding that 100% of husband's earnings and 50% of wife's earnings could be attached to pay husband's tax deficiency, incurred before marriage, because the Texas Family Code makes all husband's sole management community property subject to husband's pre-marriage tax liability, the Texas Constitution gives husband a 50% interest in wife's sole management community property, and because the exemptions set forth in the Texas Family Code exempting wife's sole management community property from being subject to the payment of husband's pre-marriage tax debt was ineffective against the federal government's claims to collect unpaid taxes).

Similarly, to determine whether a non-debtor spouse's income is a part of the debtor spouse's bankruptcy estate, for Chapter 13 purposes, a bankruptcy court consults Texas state law when the bankruptcy code does not address the matter. *In re Nahat*, 278 B.R. 108, 116 (Bankr. N.D. Tex. 2002)(concluding that non-debtor spouse's income should not be included in the debtor spouse's bankruptcy estate since Family Code Section 3.202(b)(2) provides that community property subject to a spouse's sole management, control or disposition is not subject to any non-tortious liabilities the other spouse incurs during the marriage).

Thus, the impact that Family Code Sections 3.101, 3.102, 3.201, and 3.202 have on the law extends well beyond what family lawyers consider the usual practice of family law. *Medaris*, 884 F.2d at 833 (recognizing that former section 5.61(b)(2), now Section 3.202(b)(2), creates an exemption under state law which bars a debtor spouse's creditor from subjecting a non-debtor spouse's sole management community property to the claims of the creditor).

A. Texas Uniform Fraudulent Transfer Act – TEX. BUS & COM. CODE § 24.006(a)

Texas Uniform Fraudulent Transfer Act – Prior to advising your client about a property settlement agreement, the practitioner must keep in mind the law regarding fraudulent transfers. A transfer of assets from one spouse to another pursuant to a divorce settlement may, under certain rare circumstances, be set aside as being fraudulent as to both pre-divorce and/or post-divorce creditors if the agreement was made with the intent to wire around the rights of existing creditors. Therefore, the rules regarding fraudulent transfer and the assets to which a creditor has a right to attach must be taken into consideration before advising your client regarding a divorce settlement where you suspect an intent to defraud a creditor on behalf of your client or his or her spouse.

An action to void and recover fraudulent transfers may be brought by a creditor or a trustee in a bankruptcy action. While it may be difficult to show that a property settlement was done with the intent to hinder, delay, or defraud creditors, it can be done. Recall also that the constructive fraud section of the fraudulent transfer act, located at section 24.006(a) of the Texas Business and Commerce Code, is the section of the act that can cause the most problems for the parties in a divorce situation.

As to present creditors, the Texas Business and Commerce Code Section 24.006(a) provides:

> "A transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or the obligation incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation."

Therefore, a spouse who accepts non-exempt assets in a divorce settlement should look carefully at the financial condition being created for the other spouse before agreeing to the divorce settlement.

B. And Do Not Forget …. Bankruptcy!

One must also consider a client's exposure post-divorce in the event their spouse files for bankruptcy. As noted above, the divorce decree can allocate debts as between the parties, but the decree cannot affect the rights of the third-party creditors as to joint or secured debts.

In the case of *Swinford v. Allied Finance Co. of Casa View*, 424 S.W.2d 298 (Tex.Civ.App.—Dallas 1968, writ dism'd w.o.); cert. den. 393 U.S. 923, 89 S. Ct. 253, 21 L. Ed. 259), the husband was ordered to pay all of the community debt in the divorce decree. During the marriage, the parties had jointly executed a note payable to Allied Finance Co. and after the divorce, Husband failed to pay the debt and creditor sued both parties. Ex-husband filed bankruptcy proceedings and was dismissed from suit but the creditor continued the suit against the ex-wife and the court found:

> The note sued upon is standard in form and provides that the signers thereof were ***jointly*** and severally obligated to pay same. Both Aline Swinford and Weldon Glenn Swinford signed the note and thereby became joint obligors. Assuming the parties were man and wife at that time and were subsequently

> divorced and the judgment of the divorce court imposed liability upon the husband for the indebtedness, yet, such action could have no legal effect upon the rights of the holder and owner of the note. Appellee is not shown to have been a party to or had any notice of the divorce action or the judgment rendered therein. It is well settled that the rights of any owner in property, aside from the exempt property, are, in a very important sense, subordinate to the rights of his creditors. The court in a divorce action has no power to disturb the rights which creditors lawfully have against the parties.

Id. at 301 (emphasis added).

The court went on to hold:

> In truth, however, the partitioning of the community property is not a disposition of it at all. There is no change of owners, but a mere ascertainment and separation of the interests theretofore exercised in common. It remains subject to the demands of creditors, and the wife receiving and appropriating property in the partition that would otherwise be liable to creditors, becomes personally liable, to the extent of the property so received, for the payment of the debts.

Id. at 301.

In addition, one must also consider a client's exposure for a fraudulent transfer claim, in bankruptcy, to set aside marital property agreements, agreed divorce decrees, or possibly even contested decrees! The United States Court of Appeals for the Fifth Circuit has issued two very interesting rulings in fraudulent transfer cases under the bankruptcy code. The first case is *Matter of Wiggains*, which involves a partition agreement that was set aside by a bankruptcy court as a fraud on creditors. 848 F.3d 655 (5th Cir. 2017). The second case, *Ingalls v. Erlewine*, involves an unsuccessful challenge brought by a bankruptcy trustee to a divorce decree, entered after a contested trial, on the grounds that the decree constituted a constructive fraud on creditors since the decree awarded the non-debtor spouse a disproportionate division. 349 F.3d 205 (5th Cir. 2003).

In *Wiggains*, husband and wife purchased an expensive home and made valuable improvements as part of their investment strategy to increase profits from a future sale of the home. 848 F.3d at 658. In the summer of 2013, the Wiggainses began marketing their home. *Id*. In August 2013, they signed a sales contract for $3.4 million. *Id*. A few days before they received the purchase offer, two significant events occurred. *Id*. First, the Wiggainses, upon the advice of counsel, executed and filed a "Partition Agreement," which sought to recharacterize their home from community property to separate property, one half belonging to each spouse. *Id*. The Partition Agreement further provided that each spouse would have "sole and exclusive authority, management, and control of their separate property...." *Id*. Second, Mr. Wiggains filed for bankruptcy under Chapter 7 of the Bankruptcy Code one hour after recording the Partition Agreement. *Id*. He claimed an exemption for his separate interest in the home under Texas law, which is subject to the $155,675 homestead exemption cap of Section 522(p) of the Bankruptcy Code, enacted in 2005 as part of the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") to address the so-called "mansion loophole." *Id*. Mrs. Wiggains did not separately file for bankruptcy. *Id*. Mrs. Wiggains sought to recover one-half of the sales proceeds and the trustee sought to avoid the enforcement of the Partition Agreement as a fraudulent transfer. *Id*. at 658-59. By statute, a bankruptcy trustee may avoid any pre-petition transfer of assets by a debtor "that was made or incurred on or within 2 years before the date of the filing of the petition" if the debtor made the transfer "with actual intent to hinder, delay, or defraud" any past or future creditor. 11 U.S.C. § 548(a)(1)(A). *Id*. at 661.

At trial, Mr. Wiggains testified that he entered into the Partition Agreement, upon the advice of counsel, with the purpose of excluding his wife's community-property interest in the homestead from his bankruptcy estate. *Id*. at 659. He understood his bankruptcy exemption was statutorily capped at $155,675, an amount which he correctly believed the net sale proceeds would exceed. *Id*. Although the couple discussed the possibility that both would declare bankruptcy so that they could receive the double homestead exemption of $311,350, Mr. Wiggains testified that he thought entering into the Partition Agreement was the right thing to do as he did not believe his wife was obligated on his business debts. *Id*.

"The bankruptcy court held that Mr. Wiggains's 'sole actual intent in entering the Partition Agreement was to avoid the effect of the limitation placed on his homestead exemption by section 522(p) of the Bankruptcy Code,' and the court equated such intent with 'gamesmanship for the purpose of placing reachable assets outside of creditors' reach.'" *Id*. at 659. "The bankruptcy court also stated that Mr. Wiggains's 'articulated intent to preserve for his family as much money as possible is the same as an intent to shield as much money as possible from creditors....'" *Id*.

"The bankruptcy court declared the Partition Agreement avoidable as a fraudulent transfer, leaving the amount of the net sale proceeds in excess of Mr. Wiggains's exemption to be nonexempt property of the estate." *Id*. "The bankruptcy court also determined that Mrs. Wiggains had 'no right or interest in the Homestead Net Sale Proceeds by

virtue of the Partition Agreement.'" *Id.* "A principal factor in these conclusions was that the couple executed the Partition Agreement 'in the shadow of an imminent bankruptcy filing' for no other reason than to shield a portion of Mr. Wiggains's assets from his creditors, which the bankruptcy court determined 'can only be reasonably interpreted as an act done with intent to hinder and/or delay creditors.'" *Id.*

The Fifth Circuit agreed noting that it did not even need to rely on circumstantial evidence to find that the Partition Agreement was a fraudulent transfer since Mr. Wiggins freely admitted that he and his wife signed it to protect her interest from Mr. Wiggin's creditors. *Id.* at 660-64. The Court said the following in reaching its decision:

> The Trustee stipulated there was no intent to defraud, so our focus turns to whether the Bankruptcy Court clearly erred in its assessment that Mr. Wiggains had actual intent to hinder or delay his creditors. We start from the reality that a transferor's actual intent is rarely susceptible to direct proof. *See In re Dennis*, 330 F.3d at 701. Given these evidentiary difficulties, courts have looked to the circumstances of the transfer to infer intent. See id. at 701–02. When fraud is suggested, this court has recognized six "badges of fraud" to help identify that intent—factors such as inadequate consideration, close relationship between grantor and grantee, or financial condition of the debtor before and after the transfer. *See Soza v. Hill* (In re Soza), 542 F.3d 1060, 1067 (5th Cir. 2008). Though some of those factors are also useful in determining the intents to hinder or delay, the bankruptcy court did not try, nor found it necessary, to fit its analysis within the category of fraudulent badges. Neither will we. Without a list of factors, we seek to determine whether there is sufficient evidence of improper intent.
>
> Mrs. Wiggains directs us to three bankruptcy court opinions that examined the context of a transfer to determine intent. The first two present scenarios in which the bankruptcy courts denied a debtor's discharge based on a finding that the debtor acted with actual intent to hinder or delay his creditors. *Brooke Credit Corp. v. Lobell* (In re Lobell), 390 B.R. 206, 219–20 (Bankr. M.D. La. 2008); *Bank of Oklahoma, N.A. v. Boudrot* (In re Boudrot), 287 B.R. 582, 587–88 (Bankr. W.D. Okla. 2002). Having no direct testimony of their respective debtor's intent to hinder or delay, the bankruptcy courts undertook a contextual analysis to reach these conclusions. *See In re Lobell*, 390 B.R. at 219 (concluding that the debtor acted with intent to hinder her creditor based on "evidence of several badges of fraud"); *In re Boudrot*, 287 B.R. at 587 (finding "substantial evidence that [the debtors] were motivated by a desire to hinder, delay or defraud" their creditors).
>
> The third case on which Mrs. Wiggains relies more closely aligns with the facts in this case, namely, a situation in which a debtor's intent is rather clear. There, the bankruptcy court found the debtor transferred his property with the intent to hinder, delay, or defraud his creditors. *See Albuquerque Nat'l Bank v. Zouhar* (In re Zouhar), 10 B.R. 154, 158 (Bankr. D.N.M. 1981) (transfer under a previous, but not substantively different, version of the Bankruptcy Act). Unlike the debtors in *Lobell* and *Boudrot*, the debtor in *Zouhar* "candidly admitted the purpose of" his transfer was "to shield the [ ] assets from his creditors." *Id.* at 156. He also "forthrightly admitted that he ... merely utilized this method as a device to shield his assets from his creditors." *Id.* at 157. The bankruptcy court found that the debtor's "candid admission" was "supported by the sequence of events," including the debtor's purchase of a home approximately two months before filing for bankruptcy. *Id.*
>
> In summary, in the first two cases the bankruptcy courts analyzed the circumstances surrounding the allegedly fraudulent transfers because of ambiguity about intent. In the third case, *Zouhar*, as well as here, there was direct evidence of a debtor's actual intent to hinder or delay. "Actual intent ... may be inferred from the actions of the debtor and may be shown by circumstantial evidence." *In re Dennis*, 330 F.3d at 701–02 (alteration omitted) (quoting *Pavy v. Chastant* (In re Chastant), 873 F.2d 89, 91 (5th Cir. 1989)). We agree with another court that held: "When a debtor admits that he acted with the [necessary] intent ... there is no need for the court to rely on circumstantial evidence or inferences in determining whether the debtor had" that intent. *See First Beverly Bank v. Adeeb* (In re Adeeb), 787 F.2d 1339, 1343 (9th Cir. 1986).
>
> Mrs. Wiggains argues that the bankruptcy court read an illegitimate motivation in her husband's express testimony and erroneously found that his intent was to shield assets from his creditors. In support of this argument, she refers to her husband's response to the question of whether the Partition Agreement was intended to keep their homestead out of the bankruptcy estate: "I guess that's semantics. At the time we felt like it wasn't necessarily keeping anything out. At the time we honestly felt like it was more preserving [Mrs. Wiggains's] own rights."

> We agree with Mr. Wiggains's characterization; semantics and labeling are indeed involved. Keeping property in the hands of his wife is the mirror of keeping property out of the hands of creditors. It is true, as Mrs. Wiggains argues, that the property was divided to allow her to get value from the homestead. That benign purpose, though, was being pursued at the moment before Mr. Wiggains's filing of a bankruptcy petition that would have caused the entire property to go into the bankruptcy estate for the benefit of creditors, leaving no portion, beyond Mr. Wiggains's reduced homestead exemption, to endure for the couple's benefit. If not for the creditors who could make claims on the net proceeds, there was no stated need for the partition.
>
> We have previously recognized "the line between legitimate pre-bankruptcy planning and [impermissible intent] ... is not clear." *Swift v. Bank of San Antonio* (In re Swift), 3 F.3d 929, 931 (5th Cir. 1993). Courts' efforts to label their analytical approach for determining whether otherwise lawful pre-bankruptcy planning exceeds the bounds of propriety provide us a colorful cast of characterizations. *See Wolkowitz v. Beverly* (In re Beverly), 374 B.R. 221, 245 (9th Cir.BAP 2007) ("In classical terms, it is the Sword of Damocles."); *Morgan Fiduciary, Ltd. v. Citizens & S. Int'l Bank*, 95 B.R. 232, 234 (S.D. Fla. 1988) (smell test); *Zouhar*, 10 B.R. at 157 (slaughtered-hog test). We have no metaphors to contribute, so we press on.
>
> Mr. Wiggains's testimony alone reflects his clear intent to hinder the creditors, though couched in terms of allowing his wife to receive value from the home. The bankruptcy court in essence held that the necessary effect of this transfer was to deprive creditors. The bankruptcy court considered the evidence and made the finding that the intent to enter into the Partition Agreement in order to preserve value from a home for the non-debtor spouse was not legally independent from the intent to hinder and delay Mr. Wiggains's creditors in bankruptcy. The bankruptcy court based its findings of fact largely upon Mr. Wiggains's own testimony evincing the couple's strategic decision to place a portion of his assets beyond the reach of creditors.
>
> Generally, "a court can hardly expect one who fraudulently transfers property to step up and admit it under oath." 5 Collier on Bankruptcy ¶ 548.04[1][b]. Here, the timing of the transfer, coupled with the fact the partition was one of several options admittedly considered to allow as much value as possible to be retained outside of the bankruptcy estate, are relevant extrinsic evidence of improper intent even without any admissions. From the standpoint of the creditors, which is the proper perspective, the Partition Agreement sought to reduce drastically the amount available to creditors. *See Hinsley v. Boudloche* (In re Hinsley), 201 F.3d 638, 644 (5th Cir. 2000).

Matter of Wiggains, 848 F.3d at 661–63.

In *Ingalls*, a Texas divorce court awarded the non-debtor spouse a disproportionate share of the parties' community property after a contested trial. 349 F.3d at 207. The debtor ex-spouse's filed for bankruptcy less than a year after the divorce. The bankruptcy trustee sought to set aside the property division, as a constructive fraud, because the debtor had received "less than a reasonably equivalent value" in the exchange. *Id*. at 208. The bankruptcy court ruled the debtor ex-spouse had received reasonably equivalent value as a matter of law, apparently giving conclusive weight to the divorce decree. *Id*.

On appeal to the Fifth Circuit, the trustee argued for a "bright line" rule that unequal division disfavoring the debtor can never constitute "reasonably equivalent value." The non-debtor spouse argued for a "bright line" rule that the divorce decree conclusively established "reasonably equivalent value." The Fifth Circuit rejected both parties' arguments. *Id*. at 212-13. The Court noted that accepting the trustee's argument "would apparently subject every divorce decree to scrutiny in the bankruptcy court, so long as the divorce court divided the community property unequally." *Id*. at 212. This would, at a minimum, raise federalism concerns. *Id*. Ultimately, the court concluded: "Whatever concerns might arise in other cases, the divorce before us--which was fully litigated, without any suggestion of collusion, sandbagging, or indeed any irregularity--should not be unwound by the federal courts merely because of its unequal division of marital property. *Id*. at 212-13.

The very idea that the Fifth Circuit might one day seriously entertain a bankruptcy trustee's, or a creditor's, attack on a divorce decree, entered after a contested trial, on the grounds of "collusion, sandbagging, or irregularity," should make every family lawyer concerned that their handling of marital property agreements, agreed decrees, and even contested trials, should be well documented with evidence that the transactions are fair and free of any fraud.

While a detailed discussion of fraudulent transfers and bankruptcy is beyond the scope of this paper, the specter of fraudulent transfer actions inside or outside of a bankruptcy must always be considered when dividing debts. For

an excellent overview of the effects of bankruptcy on family law issues, *see Gone Broke: Issues in Bankruptcy*, 37th Advanced Family Law Course – 2009 (authored by Joseph A. Friedman).

VIII. ALTERING MARITAL RIGHTS & LIABILITIES BY WRITTEN AGREEMENT

Chapter 4 of the TX. Fam. Code, Subchapters A and B, provides a number of ways to affect statutory liability for debts including:

A. Pre-Marital Agreements

Tex. Fam. Code 4.001-4.010, allows couples entering into marriage to contract with respect to a number of things including:

(a) the rights and obligations of the parties in any property of either or both of them whenever or wherever located.

(b) the right to buy, sell, use, transfer, exchange, abandon lease, consume, expend, assign, create a security interest in mortgage, encumber, dispose of, or otherwise manage or control property.

B. Post Marital Agreements

1. Tex. Fam. Code 4.103 permits spouses to make an agreement that the income or property arising from the separate property that is then owned by one of them, or that may thereafter be acquired, shall be the separate property of the owner. This action removes income that would be at risk for liabilities under Tex. Fam Code § 3.202 from exposure by making a spouse's income from separate property exposed only for personal pre- and post-marital debt incurred by that spouse receiving this benefit under their marital agreement.

2. Tex. Fam. Code 4.201 permits spouses to convert separate property to community property which has the opposite effect in that it exposes a spouse's former separate property, now converted to community property, to exposure for payment of their spouse's tortious liabilities, and depending on management and control issues, perhaps jointly incurred community debt or debt incurred solely by their spouse both during and prior to marriage.

No attorney should allow a client to convert separate property to community property without first discussing the effect of this action on their liability for their spouse's debt and without advising their client to at least agree that this income will be under the sole management of your client, the "converting" spouse.

Obviously, these sections could allow couples contemplating marriage to drastically alter the scheme of marital liability under the Family Code by doing such things as:

- Agreeing to pay and thus becoming liable for debts that they would not be legally responsible for under Section 3.202;
- Pledging their separate or sole management community property as collateral for a debt incurred or to be incurred by their future spouse, thus exposing property that normally would not subject such to a creditor's reach; and/or
- Requiring a prospective spouse to pledge or mortgage a piece of separate property, for the purpose of obtaining funds to finance their prospective spouse's business venture.

When an attorney elects to draft a *Pre-Marital Agreement*, they must assume the responsibility to spell out (preferably in writing) the effects agreements such as this will have on their client's statutory rights under our Family Code.

Also, attorneys should advise a client entering into a *Pre-* or *Post-Marital Agreement* that their contract can address only the spouses' rights and liabilities and cannot impair the rights of existing secured creditors or be entered into with the intent to defraud any creditor, whether secured or unsecured. *See* Tex. Const. art. XVI, §15.

IX. DEALING WITH THE MOST COMMON LIABILITIES ENCOUNTERED IN DIVORCE ACTIONS

A. The Mortgage for the Community Homestead

1. "I want her forced to refinance the home…."

This is one of the most oft repeated phrases that arise in the typical scenario where a wife will be assuming the mortgage on a divorcing couple's homestead.

As a practical matter, one spouse cannot force another to refinance real property and while there is some case authority that the court can do so, *see, e.g. Burney v. Burney*, 225 S.W.3d 208, 217 (Tex.App.—El Paso 2006, no pet.), problems can still arise as no one can be certain that a spouse will be approved for refinancing and the court has no ability to influence a lender or effect a lender's rights. Agreements or orders regarding refinancing can prove hollow.

2. Requirements for Refinancing a Home

In order to refinance a home so that the debt becomes the sole responsibility of the former spouse, lenders will require that the spouse be able to qualify for the new loan independently. According to a mortgage lender that deals with refinancing in the context of divorce, the former spouse would need to complete the loan application, pay both an application and appraisal fee and provide detailed information, some of which include:

a. Income items such as –

- Signed and dated Federal Income Tax returns for the past two years
- W2s, 1099s, K-1s for previous two years
- Current paystubs for last 30 days reflecting year to date earnings and pay period
- Bank statements for all bank accounts listed on the application
- Statements or other verification of any other assets listed on loan application such as stocks, 401(k), IRA

b. Credit Items including –

- Letter of explanation for any of the following:
- Any late payments on credit report
- Default and/or foreclosure reflected on credit report
- Judgments or other liens
- Bankruptcy discharge papers
- New inquiries on credit report

It is easy to see the problems that a wife who has not worked outside the home or established credit in her own name will face when attempting to refinance. Now consider the hurdles in addition to those associated with the application.

3. The loan, types of loans available and their parameters

There are two "standard" loans, the conventional loan and the FHA (Federal Housing Authority) Loan, so consider what is required for the loan most clients would need to qualify for, the Conventional Loan.

a. The parameters for the Conventional Loan are:

- Loan to appraised value up to 95%
- Applicant must have debt to income ratio of no more than 45%
- Applicant must have credit score of 680 or above
- Applicant must have cash reserves for payment of house note for at least 2 months.

b. The parameters for the FHA Loan are:

- Loan to appraised value up to 97.75%
- Applicant must have debt to income ration of no more than 45%
- Applicant must have credit score of 620 or above
- Applicant must have cash reserves for payment of house note for at least 2 months.

When these factors are considered, one should be able to quickly assess whether the spouse assuming the mortgage in your case will be a likely candidate for a refinance.

4. Options When Refinancing is Not an Option

If your client's spouse will not qualify for refinancing, only three options exist. Option one is to order the sale of the home if refinancing cannot be accomplished within a defined time frame. Selling the home upon divorce is an option few courts will want to impose when children are involved, especially children enrolled in schools to which the home is zoned. Option two, the most frequently exercised option, is to award the home to the wife, with her being required to assume the mortgage and execute a *Deed of Trust to Secure Assumption* of the underlying mortgage and hope for the best. Option three involves co-ownership of the home for a period of time following divorce, to be followed by a sale.

a. *Deed of Trust to Secure Assumption* – Option Two

The *Deed of Trust to Secure Assumption* is the most commonly executed real estate security instrument by divorcing clients, but what does this document allow your client to do and when should default occur? Could a former

spouse's credit be ruined if the ex-spouse actually defaults on the assumed mortgage before he or she can foreclose on their former spouse?

The answers to these questions and tips for avoiding problems for your client in a situation where their spouse is assuming the home loan are as follows.

b. Protection for Holder of *Deed of Trust to Secure Assumption*

First, it is important for the holder of the *Deed of Trust to Secure Assumption* who remains obligated on the mortgage to ask the lender to directly notify him or her of any late payment or event of default by the assuming spouse in sufficient time to cure the default before a negative credit report is issued.

(1) Foreclosure

Once the non-owning ex-spouse receives notice of a potential default, there are remedies available under the *Deed of Trust to Secure Assumption* to actually foreclose on the property.

Under the terms "Beneficiary's Rights" of the *Deed of Trust to Secure Assumption*, if the spouse who assumed the mortgage fails to perform any of the obligations under the original mortgage and *Deed of Trust*, such as failing to pay note on time, or failing to pay taxes or maintain the required insurance, the non-owing ex-spouse has the right to perform and cure the deficiencies and be reimbursed on demand by the ex-spouse who failed to perform. The non-owning ex-spouse is designated as the "Beneficiary" in the *Deed of Trust to Secure Assumption*.

If funds must be advanced to prevent default, late payment, or lack of insurance, the Beneficiary can then file a notice of advancement of funds with the county clerk giving the details of the date, amount, and purpose of the advancements and the legal description of the property.

If the non-performing ex-spouse fails to reimburse the Beneficiary within the allotted time specified in the notice, the Beneficiary has the right to actually foreclose on the property and post it for sale on the foreclosure docket pursuant to the Texas Property Code. The beneficiary can then bid and purchase the property back from the former spouse if they choose.

(2) Executing the Foreclosure

If an ex-spouse has to actually foreclose under a *Deed of Trust to Secure Assumption*, it is wise to advise your former client to engage real estate counsel to assist him in executing the proper procedural requirements including required notification to other lenders. The cost of a real estate attorney may be cheaper than trying to repair severely damaged credit due to a default with the primary mortgage holder for the home.

(3) How Hard is it to Actually Foreclose on a Lien? – A Real Life Example

Surprisingly, the answer to this question is "not very hard at all," and just as important, the legal cost to your client of exercising this option can be surprisingly modest. Recently one of the authors was faced with this situation for the first time in her career and here is how the foreclosure played out:

The client husband refinanced the marital residence in his name only during the marriage. Wife was awarded the home in the divorce and was ordered to assume and pay the mortgage. Husband conveyed the property to Wife subject to her assumption of the indebtedness and Wife executed a *Deed of Trust to Secure Assumption* of the mortgage.

After divorce, the ex-wife failed to pay the mortgage for two months and the mortgage company began sending default notices to the husband. The ex-wife was notified through her counsel about the deficiency and asked to pay the arrearage and pay the note on a timely basis going forward. When the ex-wife continued to fail to make timely payments, the husband was forced to pay the arrearage and he then formally demanded reimbursement. When no reimbursement was made, the husband engaged a real estate lawyer to pursue his remedies under the *Deed of Trust to Secure Assumption*, threatening foreclosure for ex-wife's failure to reimburse him for what was paid on the ex-wife's behalf.

The ex-wife finally started to pay the monthly mortgage payments when they were due but she still refused to reimburse the ex-husband for the two payments that he had paid on her behalf. His real estate lawyer sent a second demand for the reimbursement of those funds, now requesting his attorney fees as incurred, all as provided under the terms of the *Deed of Trust*. When ex-wife failed to reimburse the payments advanced by her ex-husband and the attorneys' fees within the time frame specified in the demand letter, the home was posted for foreclosure and the notice of such posting was provided to ex-wife. On the eve of foreclosure, ex-wife paid all amounts due to our client **plus** attorney fees. She has not failed to timely make a payment since she was forced to write this check.

c. Option Three - Co-Owning Home Following Divorce and Related Issues

The third option for avoiding the risk of one spouse assuming the debt on a house, is for the divorcing couples to continue sharing the mortgage burden post-divorce.

Under this scenario, Mom remains in the home, but Dad either assumes all or part of the responsibility for the mortgage payment for a period of time following divorce, with the home ordered sold by a date certain. Often this date is tied to an event such as a child graduating from high school.

Under this option, however, there are additional liabilities to be dealt with, that being property taxes, home repairs and the issue of who will claim the deduction for mortgage interest payments.

(1) Ad valorem taxes, payment, deduction, and the payment of and claim for mortgage interest deduction

Property taxes are liabilities that are either escrowed for payment with the mortgage holder, or not, as is often the case with wealthier clients.

Be sure to address the issue of who will pay the property taxes and understand that failure to do so leaves a big "loose end" which may result in a call to you in the following December when the tax bill comes due. Recall that tax deductions exist for both the property taxes paid (26 USA §63) and the interest payments on the mortgage (26 USA § 163).

Typically, the person who pays the interest and taxes is entitled to the deduction and if the joint owners share the expenses equally, they would be entitled to share the deductions. If one joint owner pays 100% of the mortgage and property taxes, that party would be entitled to claim both of the expenses as a deduction for income tax purposes, however it is important that the joint owners communicate before filing so they don't overlap on their claims for the deduction and trigger a flag to the IRS. As with any statement related to the rules and regulation of the IRS, it is important to check the current status of deductions and exemptions before giving your client definitive advice on these tax issues.

(2) Home Repairs – Post Divorce

Liability for post-divorce home repairs can be another quagmire for clients who have not thoroughly considered the problems of co-owning a home post-divorce. A leaky roof or an air conditioning unit going out in midsummer can erupt in litigation if the financial responsibilities are not dealt with in the divorce decree. It is always best to provide for one party to assume these obligations, but don't forget to allow this party the right to recoup these expenses upon the eventual sale of the home "off the top," before the remaining net proceeds are divided between the parties.

B. Liabilities Related to Children, Other than Direct Child Support

Obviously the most common obligation to be dealt with on divorce is the direct payment of child support. However, many divorce decrees impose other liabilities on parents by contractual agreement, the most common being contractual agreements for payment of private school tuition through high school and payment of college and post-graduate tuition and expenses.

1. Enforcing Payment of Private School Tuition

The best way to ensure private school tuition is paid is have it ordered paid as child support by agreement or as a result of judicial ruling. If that agreement cannot be made, ask for the parent paying private school tuition to agree to be bound contractually for these payments.

However, a mere contractual agreement forecloses the option of jail as an incentive for payment. If the liability is not paid then the child either leaves school or your client pays the school and then sues the other parent, hoping for a money judgment for the missed payments plus attorneys' fees incurred in procuring the judgment. Bear in mind that the judgment must then be abstracted and collected, which may or may not be possible.

2. College Tuition and Related Expenses

Obviously, once a child is 18 and out of high school, all court ordered financial obligations end, bargaining for a contractual agreement to pay these liabilities is the only option for securing payment, short of an agreement to set aside community funds for the specific payment of college obligations.

If a former spouse agrees to be contractually obligated to pay for college expenses and later refuses to pay college costs as agreed, advise your client that before filing suit for breach of contract, all conditions precedent to the

enforcement of their agreement with their former spouse must be met. These conditions may include such things as the adult child maintaining the requisite grade point average, the prompt reporting of grades to the obligated parent, and properly submitting invoices for payment. If all conditions have been met, a suit for breach of contract with a resulting money judgment is the only remedy for non-payment.

One question that often arises when a parent fails to meet their contractual obligations to pay for college is who can sue? Should the plaintiff be the parent who ends up footing the bill or the child who was to benefit from the bargain? While it is best to state in your *Decree of Divorce* or *Agreement Incident to Divorce* that the child is a party to this agreement, with the right to sue for breach in his or her own name, there is authority for the child to sue and not just the parent who extracted the bargain for payment of the expenses. *Stine v. Stewart*, 80 S.W.3d 586 (Tex. 2002), *MCI Telecomm. Corp. v. Texas Util. Elec. Co.*, 995 S.W.2d 647, 651 (Tex. 1999), both holding that third parties may recover on a contract where they are intended beneficiary of a contract entered into for the benefit of the third party.

C. Credit Card and Other Consumer Debt

The second most common question regarding post-divorce spousal liabilities is the question of how to get a former spouse to pay for charges incurred on a credit card held only in the name of your client. Unfortunately, there is no "quick fix" to this problem. Often the primary wage earner in the marriage will have "the credit" and all cards are held in his or her name with their spouse having a card issued under the primary wage earner's account. If, anticipating divorce and the loss of credit privileges, the non-credit worthy spouse goes crazy – running up large credit card debt, your best option is to assign the debt to your client, offsetting it with a property award of similar value. In situations where this is not possible, the only remedy is to award the debt to the "run-away charger", with only the threat of a suit for breach of contract seeking a money judgment as coercion for the payment of the bill. This is often an empty threat where the former spouse who incurred the debt is essentially judgment proof.

D. Cars, Trucks, Boats, and Planes (but no Trains)

Once again, we encounter the issue of property titled in one spouse's name which for practical reasons must be awarded to the other spouse. The issues are the same for any mode of transportation.

Again, we often have a client who insists on their spouse re-financing the auto loan in order to take the debt in their name. This is even more unlikely than the refinance of a home loan as often the value of the vehicle is less than the amount of the remaining loan balance.

The best one can do for a client in this situation is to provide your client the option of "repossessing" the car should the former spouse go in default on the car loan. Your drafting must be clear, for example:

> "The Toyota Camry is awarded to Betty Smith subject to her assumption and timely payment of the debt which is held in Bob Smith's name. Betty Smith is ordered to timely pay all payments due to Toyota Motor Credit. Should Betty Smith fail to timely pay any obligation to Toyota Motor Credit for the Camry awarded to her herein she is ordered to surrender the car and all keys to Bob Smith, within 24 hours of written demand by Bob Smith at the address set out in his demand. Thereafter, Bob Smith may hold the car until all past due payments are made, keep the car, or sell the car at his election."

While this is no perfect solution, as it may require a contempt action to force return of the car, it may be the only option for relief.

E. Maintenance

Tex. Fam. Code Section 8.059 provides that maintenance, our only form of "Texas alimony," is enforceable by contempt provided the maintenance:

1. Was court ordered or agreed to by the parties under the terms of Tex. Fam. Code Chapter 8 – "Maintenance" – and
2. The provision sought to be enforced does not involve maintenance for any period beyond the period of maintenance that could be ordered under Chapter 8.

The remedies for contempt are the same as for non-payment of child support and include jail.

F. Contractual Alimony

Contractual Alimony is not maintenance, but a purely contractual agreement between divorcing spouses to provide a measure of support for one spouse post-divorce or to achieve a property division where one spouse may have the income, but not the cash to buy out their spouse's interest in a community asset such as a community business.

1. Security for Performance

The key to contractual alimony for the recipient is proper security for the payor's obligation. Without security, your client's only recourse on default is suit for breach of contract with a resulting money judgment which he or she may or may not be able to collect.

a. Sources of Security

1.) Shares of Stock in Closely Held Corporation

Perfection of a security interest can be tricky, especially where security may involve shares of stock in a business entity. This is the time when a call to a transactional lawyer is warranted. If the shares of a closely held family business are to be used to securitize contractual alimony, the logical choice of an attorney to assist with perfecting security would be the corporate attorney for the family business. An attorney familiar with the family business whose stock is being pledged as security may be able to assist the parties with tailoring the security interest in a manner that will avoid unnecessary restrictions on the shareholder's rights to continue to run the family business in the usual manner.

If the closely held business or partnership does not have corporate counsel and you represent the potential debtor spouse, it is important to engage the services of counsel to draft security instruments that are as "friendly" as possible to your client's interest and not overly restrictive.

However, if you represent the creditor spouse you want the maximum security available, regardless of the impediments to the debtor's spouse.

2. Real Estate

Real estate is another excellent source of security for contractual alimony and security can be accomplished with a Real Estate Lien Note secured by an interest in the real property via a *Deed of Trust*.

One caveat to using real property as security is that a party's homestead is exempt from execution in Texas and if a person's homestead is the security, your client may have to wait until that homestead is abandoned before he exercises his rights to the collateral. If the real property is not the payor's homestead, you may exercise all rights stated in the *Deed of Trust* including foreclosure and sale. If there is an existing prior lien on the property, the prior lien(s) will be paid first and the balance applied to your client's claim.

3. Life Insurance

In addition to collateral that can be reached in the event of default during debtor's lifetime, it is prudent to include life insurance as security in the event of the death of debtor prior to fulfillment of the alimony obligations. You should specify the policy and the face amount in your *Decree of Divorce* or *Agreement Incident to Divorce* and provide for ongoing verification of proof of coverage. Unfortunately, there are circumstances where life insurance is not an option, but if available, it should always be included as part of the security package.

G. IRS Debt

It is not uncommon for divorcing spouses to owe money to the IRS. Understand that under the Internal Revenue Code, when husband and wife sign a joint return, they are jointly and severally liable for the taxes. *See* I.R.C. § 6013(d)(3).

1. Options for Dealing with IRS Obligations

a Partition of Income for Year of Divorce

Where there is a history of tax fraud by one spouse during the marriage or your client is worried about their spouse's ability to pay their share of the taxes due for the year of divorce, then consider an agreement "partitioning" the parties' income for the year of divorce. Most often, the agreement partitions income to the party who earned the income as well as income from assets awarded to a party. In this instance, once partitioned, each spouse reports only his or her own earned income for the year and the income associated with the property awarded to them in the *Decree of Divorce*. The Texas Family Law Practice Manual includes partition language in the tax section of the divorce decree form to affect the partition. *See* Tex. Fam. Law Prac. Man. Form 23-1 at § 11.J.3.c. Note however, that the parties may agree to partition income from the year of divorce between themselves in another manner. For example, if Husband is the primary wage earner, and Wife has little or no earned income, it may be beneficial for her to report some income

on her tax return for the year of divorce to allow her to benefit from dependency exemptions or other tax benefits that would otherwise be unused in that year.

Though largely unused, the Texas Family Code also allows spouses, through a divorce decree, to partition "income and earnings from the spouses' property, wages, salaries, and other forms of compensation received ***on or after January 1 of the year in which the suit for dissolution of marriage was filed***." Tex. Fam. Code § 7.002(c)(1) (emphasis added). The practical effect of the statute is to permit the parties, by agreement, to affect a legal separation as of the date of filing.

b. Electing to file Married, Filing Separately

If tax returns must be filed during the divorce proceedings and suspicions abound, consider advising your client to consult with a tax professional to inquire about filing separately, rather than jointly. Unless otherwise agreed by the parties, when filing separately, each spouse must report one-half of the community income and all of his or her separate income, if any. *See* IRS Pub. 501, 555. This will help protect your client from the potential bad acts and resulting tax liability created by his or her spouse. Your client will also have the comfort of knowing that his or her tax return was property prepared and reported his or her share of the community income under his or her control and other community income so far as disclosed by their spouse. Note that if the spouses previously filed a joint return, either or both of them may amend their return to file separately; however, the return may not be amended after the due date of the return. *See* IRS Pub. 17.

c. Innocent Spouse Relief

Where IRS debt is due and owing due to bad acts of a spouse, such as tax fraud, failure to pay taxes, or failure to file a tax return, and you represent the "innocent spouse," consider advising your client to consult with a tax professional to inquire about relief that may be available under certain provisions of the Internal Revenue Code.

Most family law practitioners think of the rules for the traditional "Innocent Spouse Relief," enacted by Congress in 1971 (Pub. L. No. 91-679, 84 Stat. 2063, codified as amended at 26 U.S.C. Sec. 6013(e)), as the only relief available to a spouse in this predicament. Section 6013(e) provides that innocent spouses filing joint returns will be relieved from tax liability for omissions from reported gross income attributable to their spouse. However, Innocent Spouse Relief, as traditionally understood, is only one of the remedies available to your clients.

Congress modified the Innocent Spouse rules significantly as part of the 1998 Reform Act to expand the possibilities for relief to include, amongst other things, equitable relief. Then, in January 2012, the IRS implemented significant changes to Innocent Spouse Relief when they issued Notice 2012-8, a proposed update to Revenue Procedure 2003-61. This proposed update, which goes into effect even in the "proposed" stage, addresses the criteria used by the IRS in making innocent spouse relief determinations for section 6015(f) equitable relief cases and revises the factors for granting equitable relief. The factors have been revised to ensure that requests for innocent spouse relief are granted under section 6015(f) when the facts and circumstances warrant. When appropriate, requests are even granted in the initial stage of the administrative process. Significantly, this proposed revenue procedure expands what the IRS will take into account such as abuse and financial control by the nonrequesting spouse in determining whether equitable relief is warranted. The proposed revenue procedure also provides for certain streamlined case determinations; new guidance on the potential impact of economic hardship; and the weight to be accorded to certain factual circumstances in determining equitable relief.

d. Summary of Innocent Spouse Relief – New and Old

(1) Types of Innocent Spouse Relief

a. Traditional Innocent Spouse Relief – I.R.C. § 6015(b)

(1) Request involves a joint return which resulted in an "understatement of tax" as a result of "erroneous items" of one spouse or former spouse.

(2) The understatement must be attributable to some erroneous item or items on the return by the non-requesting spouse.

(3) The innocent spouse must show that at the time the innocent spouse signed the joint return, he or she did not know, or did not have any reason to know, that there was an understatement of tax due to an erroneous item or items.

(4) The innocent spouse must prove, based on the circumstances, that it would be unfair to hold the proposed innocent spouse liable for the understatement of tax.

(2) Example of Facts Supporting "Traditional Relief"

Husband is an established, successful developer with poor accounting. Wife is a traditional "stay at home Mom," with college education, tended full time to the parties' two young children. The parties' joint income tax return for 2012 reflects a total tax of $250,000, all of which was paid. However, in 2013 the parties are audited and the IRS assesses an additional $100,000 in tax. The wife never saw the books for the husband's business and had no knowledge of the deficiency. She would be an ideal candidate for this relief.

e. Separation of Liability Relief – I.R.C. § 6015(c)

(1) The spouses filed a joint income tax return.

(2) The spouses are no longer married or have not been members of the same household for the past 12 months.

(3) The relief request only applies to understatements of income or deficiencies; it does not apply to underpayments of tax.

(4) Note: this "no fault" relief may be the easiest option for recently divorce individuals.

f. Example of Facts Supporting Separation of Liability Relief

Husband and Wife are each self-employed, each operating their own business. During the marriage, they file joint income tax returns. After the parties' divorce, they are audited for a year in which they were married and filed a joint return. The IRS assesses an additional $100,000 in tax for the joint return attributable only to Wife's earning from her business. The "innocent" spouse will not be liable for the deficiency that is allocable to the "guilty" spouse if the income arose only from the business under the "guilty" spouse's control.

g. Equitable Relief – I.R.C. § 6015(f)

(1) A joint return was filed by the spouses.

(2) Relief is unavailable through the other provisions of Internal Revenue Code sections 6015 or 66.

(3) A request for this relief was made before the collection statute expires.

(4) Assets were not transferred as part of a fraudulent scheme.

(5) Disqualified assets were not transferred.

(6) The requesting spouse did not file or failed to file with intent to defraud the Internal Revenue Service.

(7) A tax liability attributable to the non-requesting spouse remains (with certain exceptions).

h. Relief from community property laws – I.R.C. § 66

(1) Section 66 permits a spouse to disregard community property laws under certain circumstances.

(2) As a prerequisite, relief requires that the parties did not file a joint income tax return for the year in question.

(3) Three different types of section 66 relief are available:

a. I.R.C. § 66(a) – The spouses lived apart during year in question and no part of the non-requesting spouse's earned income was transferred to innocent spouse. The effect of this option is similar to the retroactive partition of all income earned by the spouses during the year in question, though unlike a partition, this remedy is statutorily provided by federal law and does not require the agreement of the other spouse.

b. I.R.C. § 66(b) – The non-requesting spouse failed to notify innocent spouse of income before due date of return, so the innocent spouse inadvertently failed to include his or her share of this income on innocent spouse's separate tax return.

c. I.R.C. § 66(c) – Equitable relief (generally the same rules as § 6015(f))

i. Equitable Relief – Streamlined

When threshold conditions are satisfied, then IRS will make a "streamlined" determination and grant relief if:

(1) The spouses are no longer married, are legally separated, or have not been a member of the same household during the past year; and

(2) The requesting spouse will suffer economic hardship if the Service does not grant relief; and

(3) The requesting spouse did not know or have reason to know of the deficiency – or know or have reason to know that the non-requesting spouse would not or could not pay the underpayment.

It is not advisable to attempt to offer tax advice to a client in any situation, including those set out in this article. Offering tax advice and knowing enough to recognize a possible solution is a different matter. Advising clients of

what relief may be available and sending them to a competent tax attorney may be the best service you can offer a client.

H. 401(k) Loans

An uncomplicated but significant liability issue in divorce is loans taken against one spouse's 401(k) plan. Note that most 401(k) statements reflect the total balance in the account without netting out the debt, with the loan balance being reflected separately from the total account balance. Clients often forget about these loans and a failure to closely examine statements submitted by your client could lead to an unpleasant post-divorce surprise if the client realizes the debt was not factored into the division of the community estate. If the outstanding loan is tied to the opposing party's 401(k) account, any award to your client from this account should make clear that the loan is allocated to the participant's share of the account balance. A standard QDRO will generally contain an election for this provision, but be certain that this election is in the QDRO before submitting it for court approval.

X. DEALING WITH THE NOT SO COMMON LIABILITIES

A. Contingent Liabilities

1. The Problem

A contingent liability is a debt (often a personal guarantee) that will be triggered only under certain circumstances, such as the default of a partnership on a loan obligation which a spouse partner has personally guaranteed.

Take this example: Your client is one of the two equal partners in a construction company. The construction company obtained preliminary construction financing which was personally guaranteed by both partners. The company built an apartment complex in Galveston. One week after completion, but before converting to permanent financing, the complex is severely damaged by a hurricane. The complex is underinsured. The bank wants the construction loan repaid in full. Forced into bankruptcy over this predicament, your client winds up losing everything but her exempt assets.

If, six months before the disaster, your client's husband walked away with assets totaling $6,000,000.00 with no recognition of this potential liability in this settlement, your client may be very angry when she alone is left to deal with this contingent debt which has now ripened into a full blown personal obligation.

2. The Solution

It is up to us as attorneys to assist the client in analyzing the real risk in not insisting on a contingency plan being built into the decree to deal with a contingent liability such as this.

For example, in this fact scenario the wife/partner could have asked that 50% of the contingent community liability be escrowed until the project closed into permanent financing and the construction loan was paid off.

Often in these situations opposing party may take the position that the liability, being contingent, should not be considered. If the case is settled on that basis, and the contingent liability is later triggered, then the property division is ex post facto altered by the amount that the spouse must pay on the contingent claim. A good response to a claim that a contingent liability is "not real" is to request, that the spouse making this claim, agree to indemnify the spouse who is liable for 50% of this "fake" debt just in case the contingent liability is triggered. If the other spouse won't share this risk, then the claim of "no risk" is a hollow one and a judge will quickly recognize this ploy.

B. Charitable Pledges – Churches, School, Fine Arts

Often wealthier clients may have pledges, either individually or as a couple to a charitable organization, school, church or synagogue.

Contract law governs whether a charitable pledge is enforceable. In Texas, the elements of an enforceable contract are: (1) an offer; (2) acceptance of the offer; and (3) consideration. Generally, a charitable pledge lacks consideration as the charitable organization usually does not give anything in exchange for the pledge, and the promissor does not seek anything in exchange for the pledge.

While most charitable pledges lack consideration, some do not. In cases where consideration exists, a Texas court may find that an enforceable contract was formed at the time the pledge or promise was made. *See Vanegas v. Am. Energy Servs.*, 53 Tex. Sup. J. 204 (Tex. 2009) (holding that employer's promise to pay five percent of the proceeds of a sale or merger of the company to employees who were still employed at the time of the sale or merger was enforceable).

However, even when consideration is absent, Texas courts have found some charitable pledges to be enforceable based on the doctrine of promissory estoppel, or detrimental reliance. Under the doctrine of promissory estoppel, a court may find that a contract exists where there is (1) a promise; (2) foreseeability of reliance thereon by the promissor; and (3) substantial reliance by the promisee to his detriment. The Texas Supreme Court has previously held that a charitable pledge is enforceable on the theory of promissory estoppel. *See Hopkins v. Upshur*, 20 Tex. 89 (Tex. 1857) (ruling that the pledge was a voluntary agreement that matured into an enforceable contract under the doctrine of promissory estoppel when the organization relied on the promise to its detriment).

Though the charitable organization in Hopkins had taken substantial steps in reliance on the pledge, Texas courts have not always required such substantial reliance. *See Rouff v. Wash. & Lee Univ.*, 48 S.W.2d 483 (Tex.Civ.App.—Galveston 1932) (holding that the pledge became a valid and irrevocable obligation, since "under all the given circumstances. . . [the] subscription did not fail because the objective for it had not been fully attained.").

Not only are these debts an embarrassment if unpaid, they may be enforced by the organization creditor. Spouses should be aware of the potential enforceability of these pledges before agreeing to be "ordered" to pay such debts.

C. Margin Debt

Margin debt consists of the funds borrowed from a brokerage firm often for the purchase of additional securities, with the existing portfolio being the collateral for the debt.

The problem with margin debt is that the debt is a fixed amount, not subject to market fluctuations, while the assets purchased on margin are subject to these forces. The amount of margin debt that the brokerage firm will permit is typically a percentage of the total value of the account. If the ratio of account value to debt in the account dips below the permissible percentage allowed by the margin contract with the brokerage firm, the firm will demand a payment in the form of a margin call and the brokerage firm has the right to sell off assets to cover the debt that is due if payment is not immediately forthcoming following demand.

It is usually preferable to insist that margin debt be retired on divorce. Unless your client is an extremely savvy investor who understands the risks involved in taking a brokerage account subject to margin debt, retirement of the margin debt this is the safest course for settlement.

D. Loans to Shareholder in Closely Held Corporations

Often smaller, closely held corporations will loan funds to a shareholder, sometimes in lieu of compensation or dividends. Often these loans are carried on the books of the corporation to be re-paid at some later date, such as upon year end profit distributions or the sale of the entity or its assets. Often shareholders forget about these loans, which are not easily noted on tax returns but which should be reflected on any corporate balance sheet. Identifying these loans is important and is usually one of the issues that should be recognized and addressed by a business valuation expert.

If not identified, the client owing funds to the corporation will quickly realize that their property division was skewed in favor of their spouse by their attorney's failure to identify this liability. The issue involves not only the unidentified debt but the tax due by the shareholder once the loan is repaid with money that will be taxed, perhaps at the highest marginal tax rate instead of the full-face value of the loan. For a discussion of the validity of recognizing such a loan as a true liability *see Hasselbalch v Hasselbalch*, 2002 WL 188826 (Tex.App.-Houston [1st Dist] 2002, no pet.).

E. Cash Calls

1. <u>The Problem</u>

When dealing with investments such as partnership interests, it is important to determine if the interest to be awarded is subject to cash calls to fund the ongoing expenses of the investment, such as the cash calls associated with a working interest in oil and gas properties.

You cannot advise your client as to the advisability of taking an interest in a partnership or a working interest in an oil and gas property until you have reviewed the *Partnership Agreement* or other governing investment document defining all potential ongoing investment requirements. Divorcing spouses, without their own ongoing source of earned income, may find it difficult, if not impossible, to fund ongoing cash calls. Failure to make these calls often results in the diminishment or complete forfeiture of an investor's interest.

2. Possible Solutions

One way to wire around this problem is to consider having the partner spouse assign the non-partner spouse an interest as a "transferee" in the case of a general partnership (V.T.C.A. Bus. Org. Code §152.404(c) 2006) or as an "assignee" in the case of a limited partnership (V.T.C.A. Bus. Org. Code § 153.254(a)) both of which provide that until a transferee/assignee is admitted as a partner, they shall not have any liability as a partner and thus are not subject to cash calls.

Assignment of a partnership interest is typically governed by the partnership agreement which must be reviewed carefully to ascertain if there are any restrictions on transfer upon divorce. Do be cautioned that issues as complex as assignment or transfer of partnership interests and the attendant rights and duties should not be dealt with without the assistance of a good transactional attorney.

F. Phantom Income and Surprise Tax Liabilities

Not all tax surprises come in the form of fraud perpetrated by a spouse. Often these tax surprises result from phantom income generated by investments in partnerships that may generate reportable income to an investor, when the income was not actually received but rather reinvested in the business itself. While this may be a sound business practice which may create a much more valuable investment in the long term, in the short term it can mean a surprise tax bill that your former client did not expect and may struggle to pay. Also, be cautioned that eliminating the problem of cash calls by awarding one spouse an assignee's interest in a partnership does not eliminate the risk of receiving phantom income without distributions needed to pay the tax. Recall that, as with all partnership interests, partnership income passes through to the personal tax returns of the partners and assignees.

Again, only a thorough review of the investment instruments as well as previous tax returns pertaining to the partnership interest your client is considering taking as part of his or her share of the community estate will prevent this type of tax surprise.

XI. OTHER PRACTICAL STEPS TO PROTECT YOUR CLIENT AGAINST THE EFFECT OF MARITAL LIABILITIES POST-DIVORCE

After understanding the scope of a creditor's post-divorce reach, it is a good bet that your client's spouse will be awarded debt that, if unpaid, will attempt to be collected from your client.

In addition to other tips for remedying this problem set out in this article, consider these additional defensive measures:

A. Indemnification

These clauses can be found in the State Bar of Texas Family Law Practice Manual and should be broadly drafted and included in every decree and referenced in all *Mediated Settlement Agreements*. While the indemnification is meaningless when defending against a creditor, it will provide the right to sue the defaulting ex-spouse for indemnification.

B. Consider Bargaining with Creditors

If one or both clients is on the brink or default or certain credit obligations or in bankruptcy, try to resolve creditor issues before the divorce is final. If your client wishes to be awarded an asset that is security for a debt to be assumed by their spouse, attempt to negotiate a substitute collateral to be awarded solely to the debtor. Even if these strategies fail, your client will at least have an honest assessment of the risks they face.

C. Set Your Client Up for Successful Contempt Proceeding

If your client is to have true protection, you must order any debt to be assumed by their spouse to be paid by a date certain from a specific fund in existence on the date of divorce or from an asset that is to be funded or to mature in the future.

Imprisonment to compel the payment of this type of debt is not imprisonment for debt under Article One, Section 18 of our Texas Constitution. *Ex Parte Sutherland*, 110 S.W.3d 81, 83-84 (Tex.App.—Houston [1st Dist] 2003, no pet).

It should be noted however that a divorce court cannot require spouses to liquidate property which is exempt from creditors and pay the sums received to unsecured creditors. *Delaney v. Delaney*, 562 S.W.2d 494 (Tex.Civ.App.—Houston [14th Dist] 1978, writ dism'd).

D. Do Complete Discovery

Do your best to identify all existing debt as you cannot plan for what you do not know exists. Force the filing of a sworn inventory in every case. This practice has become more lax as many settlements conclude in mediation, before sworn inventories have been forced by trial deadlines.

When a spouse is actively engaged in a private business, obtain and review all loan guarantees to ensure that your client is not going to be awarded assets pledged to a bank or other lender.

Finally, try to force the production of a credit report from opposing client to ensure no debt goes undivided.

XII. CONCLUSION

Marital liabilities are not to be feared, but to be embraced. Understanding the law and concepts laid out in this paper will help you successfully conclude your client's family law cases as well as help your client plan for and try to protect against some of the potential pitfalls that await those who choose to ignore the law regarding spousal liability and the liability of their property to third party creditors. Remember, you ignore the law at your own risk!

APPENDIX

"A"


Husband's Separate Property
Husband's Sole Management Community Property
Joint Management Community Property
Wife's Sole Management Community Property
Wife's Separate Property
Husband's Separate Debt
Husband's Pre-Marital Liabilities
Husband's Non-Tortious Liabilities During Marriage
Husband's Tortious Liabilities During Marriage
Wife's Tortious Liabilities During Marriage
Wife's Non-Tortious Liabilities During Marriage
Wife's Pre-Marital Liabilities
Wife's Separate Debt
Joint Liabilities of the Spouses

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