3)

1. Wendy and Hank's Rights In:

a. The Chex Oil Stock

Community property is recognized in California. Community property (CP) is property acquired during marriage that is not acquired by gift, bequest, or devise. Separate property (SP) is any property that is not community property. Quasi-community property (QCP) is any property acquired during marriage out of California, that would have been community property had it been acquired in California. In characterizing an asset, a court will look to (1) the source of the property, (2) the actions taken by the spouses that can change the characterization of the property, and (3) any presumptions that may apply.

In this case, Wendy inherited $150,000 during her marriage to Hank which will be automatically characterized as SP unless the spouses change that characterization. $50,000 of the SP was used to purchase Chex Oil Stock. Under the facts it is unclear where those stocks were held and if it was placed in a brokerage account. Under the Source Rule, the Chex Oil Stock will remain SP so long as it is clearly traceable. For example, if W opened a brokerage account for the purpose of buying the Chex Oil Stock with her inheritance, then the Chex Oil Stock will remain as SP even if the stock changes in value. Any earnings received from this stock will be classified as SP.

So long as Wendy does not commingle her Chex funds with any joint accounts and the funds are clearly traceable, Hank will have no rights to the stock.

b. the Restaurant (Van Camp / Pereira valuation)

As discussed, Wendy's inheritance is initially classified as SP. Wendy used her SP to purchase a restaurant. There are no facts to indicate that Hank contributed any of his own SP funds or that the community contributed any funds.

Upon dissolution of marriage, a court may apply two theories in valuing a business. The Van Camp method favors separate property and considers the capital invested into the business in determining the final valuation. The Pereira method tends to favor community property, and values the business based on a spouse's skill and effort contributed in increasing the value of the business.

In this case, Hank managed the restaurant through his own efforts since 2007. At the time of purchase the restaurant was worth $100,000 and now it is worth $300,000. If the court uses the Van Camp method, the $100,000 (the initial capital) will be given W as SP and remaining $200,000 will be characterized as CP. If the court uses the Pereira method, the entire $300,000 will be considered CP since Hank solely managed the restaurant and because Wendy was the sole contributor of the initial capital to start the business. Hank will prefer the Pereira method since he and Wendy will have one-half interest in the restaurant, but Wendy will prefer the Van Camp method because her interest would be $200,00 and Hank's interest would be $100,000.

A California court will probably apply the Pereira method in valuing the business because Hank "managed the restaurant" and it reached a final value of $300,000 "solely through his own efforts." The court will want to reimburse Hank for his efforts in making this restaurant successful and prosperous. The $100,000 that Wendy contributed from her inheritance will be considered a gift to the community. Each spouse will have a one-half interest in the restaurant.

c. the rental property

As discussed, any inheritance acquired during a marriage is initially considered separate property.

In this case Hank inherited an unimproved lot in 2008, worth $75,000. The lot, even though real property, is presumed to be SP. The court will look to Hank and Wendy's actions since 2008, that may have changed the character of the final, improved lot worth $500,000.

Loan to Make Improvements

In determining the character of a loan, a court will look to the title of the debt and will also look to the lender's decision in determining the amount of the loan. If a lender considers both the husband's and wife's assets and/or earning capacity, the loan will typically attributable to the community, regardless of whether the loan was only given to one spouse.

Here, Hank and Wendy obtained a construction loan for the purposes of building a rental house on it. Though the ownership of the loan is unclear from the facts, a court will consider the bank's reliance on the loan. In insuring this loan, the bank relied on the salaries of both spouses and also on the stock owned by Wendy. A court will find that the loan is attributable to the community, and not just Hank alone, even though the loan to improve Hank's SP.

Feathering the Nest

Courts also consider improvements to real estate that is owned as SP. If the payments for the improvements are made from community property, then any improvements increasing the value of the SP will be considered a gift to the SP.

Here, the improvement the lot was made possible by the loan received by both Hank and Wendy. The funds where not simply based on funds already obtained, but on a loan that was based on the salaries of both spouses. While Hank will argue that Wendy made a gift to his SP, she will argue that the improvements were only possible because of her salary. Wendy's argument is also augmented by the fact that she had to pledge her Chex Oil Stock, which was a traceable SP asset.

Rights in the rental property

The value of the improvement is worth $425,000 [$500,000 - $75,000]. In determining the final rights upon dissolution of marriage, a court will consider the loan, the basis of the bank's decision to lend money, and also the value of the improvement. The final improved lot will probably be characterized as a community property since it took both spouses efforts to imrpove the lot and construct the rental house. Thus, both Hank and Wendy will have a one-half interest in the total value of the improved lot, which is a one-half interest in $500,000 upon dissolution of their marriage.

2. Cathy's Judgment

In deciding how to apply a judgment, courts look at how the judgment was rendered. If the judgment was attributable to the actions of only one spouse, the person entitled to the judgment can reach funds from the community and also the liable spouse's SP, but the non-liable spouse SP will not be reachable. If the judgment was made based on the actions taken by the community, then funds from the community as well as funds from both spouse's SP will be reachable.

In this case, Cathy was a customer of the restaurant and she obtained a judgment against Hank alone. Presuming this was a tort action, Hank will argue that the tort was committed during the course of the business, which was beneficial for both spouses. Even though Hank was managing the restaurant alone, he and Wendy have a half-interest in the restaurant (discussed above). As such, Hank will argue that not only should Cathy's judgment be rendered on Wendy's and Hank's CP, but also each of their SP.

A court will also consider Wendy's benefit from the restaurant. Cathy was a customer and probably a paying customer. Even though Wendy was absent from the restaurant, she was receiving the financial benefit of having Cathy as customer in this restaurant. Although the judgment was in Hank's name alone, a court will most likely find that the spouses CP and each of their SP can be reached by Cathy's judgment. Therefore, Cathy can reach the community property and both spouse's SP.