2)

Community Property Presumption:

California is a community property state, which means that all property acquired prior to marriage is considered separate property, and all property acquired during the marriage is considered to be community property unless it was from a bequest, descent, the rents and profits of separate property, or when separate property is used to purchase property directly during the marriage in some circumstances. Community property is divided in kind at the time of judgment unless an exception applies.

What are Harry's and Winona's rights and liabilities regarding:

1. The Acme stock:

Separate Property Claim:

As discussed above, property acquired after marriage is presumed to be community in nature. However, the proponent of a separate property reimbursement claim may be able to rebut this presumption through a tracing in one of two (2) ways: the direct tracing method, or through the exhaustion method.

Here, Harry purchased the Acme stock for $1,000 from a separate bank account that he had prior to marriage--then valued at $10,000. The account itself was separate property at the time of marriage. However, when Harry married Winona, he deposited at least one $3,000 salary check into the account, at that point, he commingled the two accounts raising the community property presumption. Therefore, Harry will need to prove his Family Code section 2640 reimbursement claim through a tracing as discussed above in order to prove that the $1,000 initial investment was separate property in nature to prove the stock is separate property.

Direct Tracing:

A direct tracing can be accomplished by showing that the separate property flowed directly from one account into another which was not, then, commingled with community property funds.

Here, Harry commingled the funds, and will be unable to show that the separate property flowed directly into another unmolested account.

Therefore, Harry cannot prove direct tracing.

The Exhaustion Method:

When a commingled account exists, the separate property claim can be proven by showing that the community funds therein were insufficient to cover the community expenses at the time those expenses arose. However, this is generally difficult and too burdensome to do without the help of forensic accountants.

Here, however, Harry had $10,000 in the account at the date of marriage, and he then deposited $3,000 into the account from his community property income. He then used this account to pay down at least $4,000 in community expenses. This left $9,000 in his bank account which means the community funds were insufficient to cover the community expenses. Thereafter, Harry purchased the Acme stock.

Therefore, the initial investment of $1,000 into Acme stock will likely be found to be separate property for which he may be entitled to a dollar for dollar reimbursement as well as the future profits.

2. Disability insurance:

Post-Separation Insurance Policy Payments:

Income earned post-separation is generally considered to be the separate property of the receiving party.

Here, the question is with respect to post-separation payments. The parties were separated after counseling failed, discussed infra. Winona purchased the insurance policy with community funds raising the presumption that it was community property in nature. After, she began to receive payments in the form of community property income. If the Court finds that the disability insurance is more akin to a retirement account, then the court may make an order that the Harry will receive a portion of those payments into the future which would need to be divided by a Qualified Domestic Relations Order (QDRO) and filed with the insurance agency for direct payment. However, for all intents and purposes, the community also benefited from the income during the marriage and the income can be used to pay community debts after marriage.

Therefore, it is more likely than not that the court will find the income received during marriage to be community, and the post-separation income generated from the actual insurance policy to be separate property income--still available for the purposes of calculating support.

3. The investment account:

Separation:

The court defines separation as at least one party's intent to abandon the marriage without hope of reconciliation.

Here, the parties decided to live separately, but they continued to go to counseling with the hope of reconciliation.

Therefore, the parties were not separated at the time that Harry purchased the investment account.

<u>Fiduciary Duty:</u>

The Family Code requires that married couples have a fiduciary duty to one another. This duty requires good faith and fair dealing, and to act as a reasonable person in making investment decisions. Moreover, one's poor investment alone is not enough to breach this duty, there must be reckless negligence on the part of one spouse.

Here, Harry and Winona were still married, living apart, when he decided to gamble community income away at a casino. Luckily, Harry was able to win a large amount of money, but he failed to disclose this money to Winona. Moreover, Harry unfairly disabused her of the winnings and her right to use them for the community's benefit and unjustly enriched himself by creating a separate investment account. As a result, Harry will likely be found to have breached his fiduciary duties to Winona as well as his duty of loyalty to her. The Family Code creates specific remedies for this sort of breach under certain circumstances, and has the authority to award up to 100% of the undisclosed investment account to the aggrieved spouse if there is a finding of actual fraud. Here, actual fraud is not present because it does not appear that Harry acted with malice in his intent to deceive Winona. Nevertheless, she will be entitled to her share of the community property investment account.

Therefore, the investment account is community property in nature.

4. The loan for a sailboat:

<u>Separation:</u>

See rule above.

Here, the parties decided that after counseling, they would not reconcile, and Harry filed for dissolution. This ordinarily starts the period of separation prior to a final divorce judgment--6 months minimum in California.

Therefore, the parties were separated at the time Harry took out a loan.

Post Separation Debt:

When a debt is incurred by a party post-separation, it may be considered community in nature if it is used for the benefit of the community or to improve community property.

Here, Harry used the loan to purchase a sailboat to "relieve the stress of the divorce." It is unlikely the case that such a loan will be considered to be for the community's benefit, because Harry specifically purchased a sailboat for his own benefit.

Therefore, the loan used to purchase the sailboat is Harry's separate property, and he will be responsible for paying it down.

Conclusion:

The investment account will likely be proven to be Harry's separate property through exhaustion. Although, if Harry fails to disclose this account through to the date of trial, he may forfeit a share of the profits for breach of his fiduciary duties during the proceedings. The post-separation disability insurance payments are going to be seen as Winona's separate property income, and that income may be used to calculate support. The investment account is community property in nature. The post-separation sailboat loan is Harry's separate property debt.

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END OF EXAM