Treating Quasi-Community Property as Community Property for Debt Collection: Due Process and Policy Concerns

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TREATING QUASI-COMMUNITY PROPERTY AS COMMUNITY PROPERTY FOR DEBT COLLECTION: DUE PROCESS AND POLICY CONCERNS

I. INTRODUCTION

The community property system in California is in the process of continuing growth and definition. Since the early part of this century, the California Legislature has attempted to solve some of the system's problems. One of the main stumbling blocks which has continuously troubled the Legislature is the classification and liability of property acquired by a married couple outside California which they bring with them when moving to California.

In the past this property has been considered the separate property of the title-holding spouse. Classification as separate property had shielded it from liability for community debts. However, in 1984 the California Legislature enacted two statutes which changed the traditional classification of property acquired by a married couple outside of California. California Civil Code sections 5120.020 and 5120.120 treat this separate property as community property for the purposes of liability for debts.

Prior to 1984, property brought into California, acquired in a common law state, was given the label quasi-community property.¹

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¹ 1988 by Susan Mayer

* The author would like to thank two Santa Clara University School of Law professors for their help on this project: Fr. Paul Goda, S.J. who read many versions of the comment and Professor June Carbone.


   CAL. CIV. CODE § 5120.020 provides: “‘Community property’ includes: a) Real Property situated in another state that would be community property if situated in this state. b) Quasi-community property.”

   CAL. CIV. CODE § 5120.120 provides: “For the purposes of this chapter, quasi-community property is liable to the same extent, and shall be treated the same in all other respects, as community property.”

2. Quasi-community property is defined by CAL. CIV. CODE § 4803 (West 1983). It provides:

   As used in this part, “quasi-community property” means all real or personal property wherever situated, heretofore or hereafter acquired in any of the following ways:

   (a) By either spouse while domiciled elsewhere which would have been community property if the spouse who acquired the property had been domiciled in this state at the time of its acquisition.
It was treated as separate rather than community property. There were only two narrow exceptions to this rule: death of the title-holding spouse and dissolution of the marriage.

Under the new statutory scheme, quasi-community property is treated the same as community property for the purpose of collecting debt, thereby making it liable for community debts. It seems clear that there are severe due process and policy problems presented by these statutes.

To justify this reallocation of property rights under California law, the Legislature must identify a sufficient state interest and demonstrate that the disturbance of a vested property right is necessary to achieve the state's interest. As will be shown below, the state cannot meet this burden.

(b) In exchange for real or personal property, wherever situated, which would have been community property if the spouse who acquired the property so exchanged had been domiciled in this state at the time of its acquisition.

3. CAL. CIV. CODE § 5110 (West Supp. 1988) defines community property as "all real property situated in this state and all personal property wherever situated acquired during the marriage by a married person while domiciled in this state, and property held in trust pursuant to Section 5110.150 is community property."

4. Section 4800 of the Civil Code defines the method of dividing property at dissolution. It provides that the "community estate" shall be divided equally between the spouses. Section 4800(a) defines "community estate" to include both the community and quasi-community assets and liabilities of the parties.

CAL. CIV. CODE § 4800(a) (West 1988) provides:

(a) Except upon the written agreement of the parties, or on oral stipulation of the parties in open court, the court shall, either in its interlocutory judgment of dissolution of the marriage, in its judgment decreeing the legal separation of the parties, or at a later time if it expressly reserves jurisdiction to make such a property division, divide the community property and the quasi-community property of the parties equally. For purposes of making this division, the court shall value the assets and liabilities as near as practicable to the time of trial, except that, upon 30 days' notice by the moving party to the other party, the court for good cause shown may value all or any portion of the assets and liabilities at a date after separation and prior to trial to accomplish an equal division of the community estate and the quasi-community property of the parties in an equitable manner.

For the purposes of division and in confirming or assigning the liabilities of the parties for which the community estate is liable, the court shall characterize liabilities as separate or community and confirm or assign them to the parties in accordance with subdivision (c).

CAL. PROB. CODE § 101 defines the same equal division in the case of death of the title-holding spouse.

5. See infra section III.
II. BACKGROUND: HISTORICAL TREATMENT OF QUASI-COMMUNITY PROPERTY AND ITS EFFECT ON SECTION 5120.120

A. Past California Statutes and Case Law

In 1917, the California Legislature enacted Civil Code section 164 which provided that property acquired in a common law state converted into community property when the married couple established a domicile in California.\(^6\) This was the first attempt to divest a spouse of a vested property right in what was later to be called quasi-community property. However, the California Supreme Court in *In re Thornton's Estate*,\(^7\) tested the constitutionality of a statute declaring property acquired in Montana to be community property upon entering California and held section 164 unconstitutional:

> If the right of a . . . citizen of California, as to his separate property, is a vested one and may not be impaired or taken by California law, then to disturb in the same manner the property right of a citizen of another state, who chances to transfer his domicile to this state, bringing his property with him, is clearly to abridge the privileges and immunities of the citizen.\(^8\)

Similarly, the California Legislature enacted Probate Code section 201.5 to achieve the same result as at the death of the title-holding spouse. Probate Code section 201.5 provided:

> Upon the death of either husband or wife one-half of all personal property, wherever situated, heretofore or hereafter acquired after marriage by either husband or wife, or both, while domiciled elsewhere, which would not have been the separate property of either if acquired while domiciled in this state, shall belong to the surviving spouse, . . . subject to the debts of the decedent and to administration and disposal under the provision of Division 3 of this code.

This section purported to give the deceased, non-title holding spouse the power of testimony disposition over the “quasi-community” property of the other spouse. This Probate Code section was

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6. CAL. CIV. CODE § 164 (1917) provided:
   All other property acquired [not classified as separate under §§ 162 and 163] after marriage by either husband or wife, or both, including real property situated in this state and personal property wherever situated, acquired while domiciled elsewhere, which would not have been the separate property of either if acquired while domiciled in this state, is community property.
7. 1 Cal. 2d 1, 33 P.2d 1 (1934).
8. Id. at 5, 33 P.2d at 3.
declared unconstitutional in *Paley v. Bank of America.* The court found that to take the vested, separate property rights of the title-holding spouse and expose the property to the unilateral testamentary action of the other spouse would be to strip a living person of his sole and separate property. This result was condemned as unconstitutional in line with the court in *Thornton’s Estate.*

In 1961, the Legislature enacted Civil Code section 146 which required equal division of community and quasi-community property between the spouses at divorce, except under limited circumstances. The California Supreme Court in *Addison v. Addison* held this statute constitutional because it did not deprive a property right of the owner of quasi-community property without due process. The court found that the protection of the innocent party’s rights in marital property provided a legitimizing state interest. “We are of the opinion that where the innocent party would otherwise be left unprotected[,] the state has a very substantial interest and one sufficient to provide for a fair and equitable distribution of marital property without running afoul of the due process clause of the Fourteenth Amendment.”

B. **Section 5120.120**

Current section 5120.120 is really a classification statute. Classification of property in the community property system establishes specific property rights and defines the property’s liability for debts. It provides that any property, held in the name of either spouse, which would have been community property if the couple had acquired the property while domiciled in California is classified

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   In case of the dissolution of the marriage by decree of a court of competent jurisdiction or in the case of judgment or decree for separate maintenance of the husband or wife without dissolution of the marriage, the court shall make an order for disposition of the community property and the quasi-community property . . . as follows:
   
   (b) If the decree be rendered on any other ground than that of adultery, incurable insanity or extreme cruelty, the community property and quasi-community property shall be equally divided between the parties.

12. *Id.* at 567, 399 P.2d at 903, 43 Cal. Rptr. at 103.
13. See Appendix.
14. A classification statute defines the nature of property within the community property system. The classification occurs at the time of property acquisition.
as community property for the purposes of debt collection.

C. Public Policy Considerations Surrounding Section 5120.120

The state interest cited to legitimize the classification of quasi-community property as community property is the need to promote "the sharing of common obligations[;] . . . [to] help insure equal access to credit by both spouses[;] and [to] protect California creditors who extend credit in reliance on the availability of marital assets to satisfy debts."18

Statutes that reallocate the ownership of vested property rights in marital property have been found to be constitutional only at the time of death of the title-holding spouse and at the time of divorce. The cases cite the need to ensure an equitable division of property as the compelling interest.19

D. The Problem of Section 5120.120's Retroactivity

When the Legislature enacted the 1984 amendments to the Civil Code,7 it made them retroactive. Retroactivity of community property statutes is a hotly debated and highly controversial component of California's Civil Code.18 In 1976, the California Supreme Court decided that, in some instances, it is not unconstitutional to give a statute retroactive effect. In re Marriage of Bouquet19 involved the retroactive application of an amendment to a prior statute prescribing that earnings acquired by the husband during periods of separation were community property while earnings accumulated by the wife were her separate property. The Legislature judged that the prior situation unconstitutionally discriminated against the husband; it enacted a new statute, at issue in Marriage of Bouquet, treating both spouses equally.

The Bouquet court set out an analysis for determining when it is constitutionally permissible for a statute to be applied retroac-

17. See Appendix.
tively. First, there must be a sufficiently important government interest. Second, the retroactive application of the statute must be an important component to subserve the government's interest. Finally, the court looks to the degree of reliance placed on the statute, the legitimacy of that reliance, and the extent to which the retroactive application of the statute would disturb those interests.\textsuperscript{20}

The court found in \textit{Bouquet} that Mrs. Bouquet's due process rights had not been violated due to the strong state interest in ensuring an equitable division of marital property at divorce. It was the importance of the state interest which allowed the Legislature to apply the statute retroactively.

In 1985, the court reaffirmed this analysis in \textit{In re Marriage of Buol}.

\textsuperscript{21} \textit{Buol} considered the constitutionality of retroactively requiring a writing to overcome the presumption that property held in joint tenancy is community property. The court found the retroactive application of Civil Code section 4800.1 impaired the vested rights of Mrs. Buol. The court determined there to be a compelling state interest: the equitable distribution of marital property at divorce. Yet, the court found that retroactive application of the statute did not subserve the state's acknowledged interest in the equitable distribution of marital assets at divorce. The statute cures "no rank injustice" as in the \textit{Bouquet} case.\textsuperscript{22}

Thus, the court created a fourth prong to the analysis: "these cases [\textit{Addison} and \textit{Bouquet}] support the proposition that the state's paramount interest in the equitable dissolution of the marital partnership justifies legislative action abrogating rights in marital property where those rights derive from manifestly unfair laws."\textsuperscript{23} Therefore, the retroactive application must serve to eradicate an unjust prior law.

Finally, \textit{In re Marriage of Fabian}\textsuperscript{24} again reaffirmed the \textit{Bouquet/Buol} test for retroactivity in a case testing the constitutionality of applying section 4800.2 retroactively. Section 4800.2 provides a waivable statutory right of reimbursement when a spouse contributes separate property to a community asset. Before this statute was enacted, \textit{In re Marriage of Lucas}\textsuperscript{25} held that such a contribution is

\begin{itemize}
\item \textsuperscript{20} \textit{Id.} at 592, 546 P.2d at 1376, 128 Cal. Rptr. at 427.
\item \textsuperscript{21} 39 Cal. 3d 751, 705 P.2d 354, 218 Cal. Rptr. 431 (1985).
\item \textsuperscript{22} \textit{Id.} at 761, 705 P.2d at 360, 218 Cal. Rptr. at 437.
\item \textsuperscript{23} \textit{Id.}
\item \textsuperscript{24} 41 Cal. 3d 440, 715 P.2d 253, 224 Cal. Rptr. 333 (1986).
\item \textsuperscript{25} 27 Cal. 3d 808, 614 P.2d 285, 166 Cal. Rptr. 853 (1980).
\end{itemize}
considered a gift unless an agreement to the contrary can be shown.\footnote{28}

In \textit{Fabian}, the court found that there was no discernible state interest in retroactive application, except an unexplainable desire to overrule \textit{Lucas}.\footnote{27}

III. \textbf{IMPACT OF THE CREDITORS' RIGHTS STATUTES ON DUE PROCESS AND POLICY}

There are two separate and distinct due process problems presented by Sections 5120.020 and 5120.120. First, the sections attempt to divest a spouse of his or her quasi-community property rights without benefitting the title-holding spouse in any way, thereby violating due process. Second, the statutes purport to be retroactive, one of the community property system's most significant constitutional problems.

A. \textit{Due Process and Divestment of Quasi-Community Property Interests}

The system of statutes enacted in 1984\footnote{29} purports to reclassify quasi-community property as community property for debt collection purposes. Classification of property as separate, community or quasi-community is critical to the determination of whether the property is liable for debts.\footnote{30}

Classification of property takes place at the time of acquisition.\footnote{30} California courts have long struggled with the question of when and why marital property may be reclassified. Quasi-community property is treated as the separate property of the title-holding spouse during the marriage. Only at the death of the title-holding spouse or dissolution of the marriage is quasi-community property treated as community property.

\textit{Thornton's Estate}\footnote{29} involved the attempt by the Legislature to reclassify quasi-community property as community property simply because Mr. and Mrs. Thornton moved to California. The court firmly and unequivocally held that it is a violation of due process for

\begin{itemize}
\item \textit{Id.} at 815, 614 P.2d at 289, 166 Cal. Rptr. at 858.
\item \textit{Fabian}, 41 Cal. 3d at 448-49, 715 P.2d at 258, 224 Cal. Rptr. at 338.
\item See Appendix.
\item Community property is liable for all debts incurred by either spouse during marriage. \textit{CAL. CIV. CODE} \S 5120.140. Separate property is liable for its owner's debts and for the necessities of life for the non-title-holding spouse. \textit{CAL. CIV. CODE} \S\S 5120.130, 5120.140 (West Supp. 1988).
\item \textit{Fabian}, 41 Cal. 3d 440, 715 P.2d 253, 224 Cal. Rptr. 333 (1986).
\item 1 Cal. 2d 1, 33 P.2d 1 (1934).
\end{itemize}
California to take separate property rights\textsuperscript{33} from one spouse and expose that property to liability for community debts as a result of the simple relocation of a couple's domicile.

The court found property rights of the title-holding spouse to be vested. Since the separate property rights were vested, they could only be disturbed if the court found there to be a sufficient government interest and the government interest could not be served except by the divestment of the property rights. This analysis will be followed below.

1. \textit{Vested Rights in Quasi-Community Property}

The definition of vested property rights has changed over time. Before 1965, the label "vested property right" had special significance. Once the court had determined that the rights were vested, they were constitutionally protected.\textsuperscript{35} A study conducted of pre-1965 cases, identifying property rights as either vested or non-vested, showed that judges attached the term after evaluation of the importance of the rights. This determination was made by subjecting the value of the rights to a reasonableness standard. Judges used a purely subjective standard to make this determination.\textsuperscript{36}

After a judge decided that the right was or was not vested, he or she merely stated this fact in the opinion rather than articulating factors to consider in making the determination. Therefore, no guidance was given to lower courts in making the same decision in later cases.\textsuperscript{37} For example, \textit{Thornton's Estate}\textsuperscript{38} held that the rights of the title-holding spouse were vested, and the opinion followed the norm of merely stating a conclusion. The court failed to analyze why the rights were vested and simply stated:

\begin{quote}
So long as we are bound by the holding that to limit the right of one spouse by increasing the right of the other in property acquired by their united efforts is the disturbance of a vested right, we entertain no doubt of the application of at least two provisions of the Fourteenth Amendment to the Constitution of
\end{quote}

\begin{thebibliography}{9}
\bibitem{32} The term "separate property" is used to denote the treatment of quasi-community property during the existence of the marital community. The separate property acquired during marriage by a married person which would have been community had it been acquired in California may eventually be treated as quasi-community property at death or divorce.

\bibitem{33} Reppy, supra note 18, at 977.
\bibitem{34} Reppy, supra note 18, at 977.
\bibitem{35} Reppy, supra note 18, at 977.
\bibitem{36} 1 Cal. 2d 1, 3, 33 P.2d 1, 3 (1934).
\end{thebibliography}
the United States.\textsuperscript{37} However, since the 1965 decision of Addison v. Addison,\textsuperscript{38} the courts have continued to use the term vested rights, but the meaning is different. Now the term is used when the court sees the property right as one that it determines there is a duty to recognize and protect.\textsuperscript{39} The court looks to the legitimacy of the right and to the reliance the individual or society has placed on the property right at issue.

In comparing Thornton's Estate and Addison, it is clear that quasi-community property rights are vested. Thornton's Estate squarely holds that the rights are vested while Addison talks in terms of the importance of the rights. While Addison does not hold that the title-holding spouse's rights are vested within this definition, it seems clear that the court intended that the rights be considered vested.

2. \textit{The State Interest and Alternatives}

In order for the Legislature to divest one spouse of a vested property right, the Legislature must identify a sufficient state interest.\textsuperscript{40} The interest must be so fundamental and important to the state as to justify the taking of a citizen's property to serve the greater good of society.

The California Law Revision Commission found the state interest attained by this legislation to be the promotion of the sharing of assets and liabilities between married persons, equal access to credit and protection of California creditors. The legislation is also intended to help assure equal access to credit by both spouses and to protect California creditors who extend credit in reliance on the availability of marital property to satisfy debts.\textsuperscript{41}

The Commission also asserts that treating quasi-community property as community property for debt collection purposes does not pose any significant constitutional problems.\textsuperscript{42} The Commission justified this position by saying that the policy considerations are "so fundamental as to outweigh the possible impairment of private property rights."\textsuperscript{43}

\begin{itemize}
  \item \textsuperscript{37} Id.
  \item \textsuperscript{38} 62 Cal. 2d 558, 399 P.2d 897, 43 Cal. Rptr. 97 (1965).
  \item \textsuperscript{39} Id. at 566, 399 P.2d at 902, 43 Cal. Rptr. at 102.
  \item \textsuperscript{40} Id. at 558, 399 P.2d at 897, 43 Cal. Rptr. at 97. See supra section IIA.
  \item \textsuperscript{41} 17 CAL. L. REVISION COMM’N REPORTS 12 (1984).
  \item \textsuperscript{42} Id.
  \item \textsuperscript{43} Id. at 12 n.14.
\end{itemize}
However, as will be shown, the state interest enunciated by the Law Revision Commission is not sufficient to legitimize the taking of a non-debtor spouse’s separate property. The California courts have identified only a narrow state interest sufficient to justify reclassification of marital property rights. Reclassification occurs only at dissolution of the marriage or death of the title-holding spouse and exists to ensure an equitable distribution of assets acquired during the marriage. At death and divorce, this overriding concern protects children and the less economically secure spouse from an inequitable allocation of assets which would otherwise leave them financially unprotected.

The court determined that the state’s interest in reallocating marital property rights at death and divorce is particularly important due to the state’s special stake in the marital relationship. In Addison, the court cites United States Supreme Court precedent:

> Each state as a sovereign has a rightful and legitimate concern in the marital states of persons domiciled within its borders. The marriage relation creates problems of large social importance. Protection of offspring, property interests, and the enforcement of marital responsibilities are but a few of the commanding problems in the field of domestic relations with which the state must deal.

Addison takes hold of this interest and finds it sufficient enough to divest a spouse of his or her property. The Addison court distinguishes Thornton’s Estate and identifies an important line of demarcation between them. The court finds:

> The legislation under discussion [Cal. Civ. Code § 146], unlike old section 164, makes no attempt to alter property rights merely upon crossing the boundary into California. It does not purport to disturb vested rights “of a citizen of another state, who chances to transfer his domicile to this state, bringing his property with him. . . .” Instead, the concept of quasi-community property is applicable only if a divorce or separate maintenance action is filed here after the parties have been domiciled in California. Thus, the concept is applicable only if, after acquisition of domicile in this state, certain acts or events occur which give rise to an action for divorce or separate maintenance. These acts or events are not necessarily connected with a change

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44. Addison, 62 Cal. 2d 558, 399 P.2d 897, 43 Cal. Rptr. 97 (1965); CAL. PROB. CODE § 101 (West 1988); CAL. CIVIL CODE § 4800 (West Supp. 1988).
45. Addison, 62 Cal. 2d at 567, 399 P.2d at 902, 43 Cal. Rptr. at 102 (quoting Williams v. North Carolina, 317 U.S. 287, 298 (1942)).
of domicile at all.\textsuperscript{46}

Therefore, the court delineates two possible scenarios involving the divestment of property rights: one which is permissible and one which is not.

Reclassification is permissible only when, after moving to California, "certain acts or events occur" which lead to a dissolution of the marriage. Courts have held fast to the position that death and dissolution of marriage are the only times quasi-community property can be treated as community property without violating the title-holding spouse's due process rights. In other words, only the compelling state interest of protecting the other spouse, which uniquely occurs at death or divorce, is sufficient to reallocate vested property rights.

The state interest articulated by the Law Revision Commission is simply not sufficient to permit the Legislature to divest the title-holding spouse of his or her property rights.

The state interest in protecting members of the marital community, children and society at dissolution involve fundamental rights of the ex-spouse and children to receive protection from the possibility of a severe and debilitating reduction in the ability to obtain food, clothing and shelter. Society's stake is less dramatic, but its moral obligation to provide a minimum standard of living for all citizens is great.

The interests proffered by the Law Revision Commission are much less compelling. They focus on collateral needs in our society. The first goal—to promote the sharing of marital assets and liabilities between married couples—is already achieved by less intrusive means. At divorce or death, both spouses receive an equal share of the community and quasi-community property.\textsuperscript{47} Therefore, protection of the spouses exists at the end of the marital community. Safeguards also exist during the existence of the marital community. The Civil Code provides protection by making each spouse personally liable for debts incurred by the other spouse for the necessaries of life.\textsuperscript{48}

The second goal—to promote equal access to credit for married persons—is not sufficient to warrant the reallocation of marital property. Acquisition of credit is not necessary to obtain the basic requirements of life. Although credit is helpful in today's society, it

\begin{itemize}
\item \textsuperscript{46} Id. at 566, 399 P.2d at 901-02, 43 Cal. Rptr. at 102-03 (citation omitted).
\item \textsuperscript{47} CAL. PROB. CODE § 101 (West 1984); CAL. CIV. CODE § 4800(a) (West Supp. 1988).
\item \textsuperscript{48} CAL. CIV. CODE § 5120.140(a)(1) (West Supp. 1988).
\end{itemize}
is more a luxury than a necessity.

The third goal—protection of creditors—is also not adequate to support the divestment of marital property rights. The creditors do not need the benefit of this social welfare legislation. They should be required to evaluate the risks associated with extending credit to the community based on the signature of one spouse. They have the power to verify the assets owned by the community and the debtor spouse to determine whether they will benefit from their bargain. As rational decision makers, creditors should be hesitant to extend credit if they believe the potential of receiving a high rate of return is not worth the risk of dealing with only one spouse.

Specifically, creditors can require both spouses to sign a promissory note; thereby making them both personally liable for the debt. Having both signatures exposes all of the community property and all of the separate property estates of both spouses to liability for the debt. Thus, the creditor has the benefit of all possible assets from which to satisfy the debt.

From a due process standpoint, the result of taking the non-debtor spouse's property without providing him or her with any benefit was declared unconstitutional in *Paley v. Bank of America*.\(^49\) In *Paley*, the deceased wife attempted to dispose of half of her surviving husband's quasi-community estate by will. The Court of Appeal found that the deceased wife did not have the power to divest "a living person of his sole and separately owned property, by [her] testamentary action . . . having no interest of any kind therein."\(^50\) The court found that the property owned, which would have been community had they been domiciled in California, was the sole and absolute property of the husband and his wife "had no interest in it whatever, expectant or otherwise."\(^51\) The court held that to allow the wife to dispose of her husband's separate property by will, simply because she and her husband moved to California, would be unconstitutional as it "stripped" a living person of one-half of his separate property.\(^52\)

The result, which the Court of Appeal held unconstitutional, is the taking of a spouse's property without consideration. Current Civil Code section 5120.120 similarly "strips" a living person of his separate property rights. The section allows the debtor spouse to encumber the non-debtor spouse's quasi-community property and ex-

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50. *Id.* at 503, 324 P.2d at 38.
51. *Id.* at 506, 324 P.2d at 39.
52. *Id.*
Community property poses that property to liability for community and separate debts. The unilateral action of the debtor spouse is permitted to divest the non-debtor spouse of his separate property rights for which he receives no consideration.

Therefore, it is clear that the state interests articulated by the Law Revision Commission are inadequate to support the reclassification of quasi-community property as community property. Only the narrow situation of divorce may justify this action on the part of the Legislature. This situation is not present in these statutes nor are the same kinds of important interests present here.

B. Policy Considerations

The reasons which may be advanced by the proponents of section 5120.120 will not survive California’s due process analysis. The first justification for treating quasi-community property as community property for debt collection purposes may be the concept of equitable subordination. Equitable subordination is usually applied in the context of shareholder loans to corporations. The equitable doctrine allows non-shareholder creditors of the corporation to satisfy their debts from the corporation’s assets before shareholders are allowed to collect on their loans. The doctrine identifies the shareholders’ debt as inferior to that of an outside creditor. The same may hold true to an extent in a marital community. It may be justifiable to treat a third party creditor’s right as superior to that of the non-debtor spouse. The creditor has extended credit and detrimentally relied upon the existence of community assets to repay the debt. The

53. The California Law Revision Commission does not set out its analysis for enacting this statute. The points raised in this section are arguments that the author believes a proponent would make for the enactment of Cal. Civ. Code § 5120.120.

54. See supra section III for California’s community property due process analysis.

55. Equitable subordination is also known as the Deep Rock Doctrine. It is named for the famous United States Supreme Court case, Taylor v. Standard Gas Co., 306 U.S. 307 (1939). Taylor involved a corporate reorganization under the Bankruptcy Act in which Standard Gas and Electric made loans to its subsidiary, Deep Rock Oil. When Deep Rock Oil subsequently filed for bankruptcy, the parent company submitted a claim to the receiver, as did other creditors, under the provisions of the Bankruptcy Act. The Supreme Court subordinated the parent company’s claim in favor of the other creditors because Standard Gas was responsible for Deep Rock’s problems. Standard Gas contributed to these problems by mismanaging and improvidently granting loans, thus converting Deep Rock into a mere instrumentality for Standard’s own purposes. Standard thereby benefitted, at least indirectly, by the manner in which Deep Rock was operated.

This is similar to the community property context in which the nondebtor spouse benefits by the debtor spouse incurring debt from which the nondebtor is exempt.

The Deep Rock Doctrine has been reaffirmed by other courts such as the Second Circuit in Security and Exchange Commission v. S. & P. Nat’l. Corp., 360 F.2d 741 (2d Cir. 1966).
subordination of the non-debtor spouse's rights is fair because the risk of debt default should rest primarily with the community and its members rather than on the creditor.

However, equitable subordination is infected, to a degree, with the same constitutional infirmity that the *Paley* court found unconstitutional. Section 5120.120 prefers the creditor's claim over the vested property rights of the non-debtor spouse. A vested property right is entitled to constitutional due process protection which it does not receive under this statute. *Paley* determined that exposing the non-debtor's property to liability for debts during his lifetime without his consent and by the unilateral action of the debtor spouse is unconstitutional.\(^6\)

Another argument which may be advanced in favor of section 5120.120 is that it treats a marital union as a general partnership. An important aspect of a partnership is that each partner is an agent for the other.\(^7\) The California Corporations Code allows one partner to encumber all the partnership assets as well as the personal assets of the other partner.\(^8\) Using the partnership analogy, it is legitimate to allow one spouse to encumber all the community assets as well as the quasi-community estate of the other spouse. The creditor should be permitted to rely on the partnership relationship to satisfy the debt extended to the community out of the community assets, the separate estate of the debtor spouse, and the quasi-community property of the non-debtor spouse. This arrangement does

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57. *CAL. CORP. CODE* § 15009 (West Supp. 1988) provides in pertinent part:
   (1) Every partner is an agent of the partnership for the purpose of its business, and the act of every partner, including the execution in the partnership name of any instrument, for apparently carrying on in the usual way the business of the partnership of which he is a member binds the partnership, unless the partner so acting has in fact no authority to act for the partnership in the particular matter, and the person with whom he is dealing has knowledge of the fact that he has no such authority. For purposes of this subdivision, “knowledge” includes constructive notice pursuant to Section 15010.7.
   (2) An act of a partner which is not apparently for carrying on of the business of the partnership in the usual way does not bind the partnership unless authorized by the other partners.

58. *CAL. CORP. CODE* § 15015 (West 1977) provides:
   All partners are liable
   (a) Jointly and severally for everything chargeable to the partnership under Sections 15013 and 15014.
   (b) Jointly for all other debts and obligations of the partnership; but any partner may enter into a separate obligation to perform a partnership contract.
not encumber as great a base of assets as could be encumbered by a general partner. If the marital community were treated the same as a general partnership, in terms of liability for debt, the debtor spouse would be allowed to expose the non-debtor spouse's separate, quasi-community, and community estates to liability for debt.

However, this analogy does not withstand analysis. In a general partnership, a partner may only bind the partnership if he has apparent authority to do so. The other partners can prevent partnership liability by notifying creditors that the partner does not have the authority to bind the partnership. In the case of section 5120.120, the non-debtor spouse has no power to prevent the other spouse from encumbering the property. Additionally, an agent can only bind the principal to the extent of his authority. If the title holding spouse does not give such authority to the other spouse to encumber his/her property, any action by him/her should be void.

C. Due Process and the Retroactivity Issue

The California Supreme Court established an analysis for determining whether a statute which, when retroactively applied, abrogates vested property rights thereby violating due process. The test consists of four parts: (1) there must be a sufficient government interest; (2) retroactive application of the statute must be an important component in achieving the state's interest; (3) the court must determine the degree of reliance placed on the statute and the legitimacy of that reliance; and, (4) the retroactive application must serve to rid the state of an unjust law.

When enacting section 5120.120, the California Law Revision Commission found the state interest to be threefold: to promote the sharing of assets and liabilities between married persons, to ensure equal access to credit, and to protect California creditors. As discussed above, this state interest is likely not sufficient to warrant the abrogation of the vested property rights of the title-holding spouse. However, assuming for the sake of argument that the interest is suf-
1. The Importance of the Retroactivity Component

The court found in both *Buol* and *Fabian* that the state interest was not advanced by the retroactive application of the statute because the new statutes did not do away with any injustice present in the previous law. *Buol* dealt with section 4800.1 which required a writing to overcome the presumption that property held in joint tenancy is community property. The old position, that an oral agreement would overcome the presumption, was not inherently discriminatory nor did it violate any other constitutional guarantee.

*Fabian* involved the retroactive application of section 4800.2. Section 4800.2 gives a spouse, contributing separate property to improve a community asset, a right of reimbursement. Previously, such a contribution was considered a gift to the community. In enacting section 4800.2, the Legislature articulated no state interest except a vague desire to overrule previous case law. In *Bouquet*, the court relied heavily on the fact that the old statute was blatantly unconstitutional as it denied the constitutional right of equal protection to husbands by treating earnings acquired by them during separation as community property while treating those of their wives as separate property.

In this situation, quasi-community property has been treated as separate property for all purposes except at the dissolution of the marital community either by the death of the title-holding spouse or by divorce. The California courts have consistently insisted that this is the proper treatment of California marital property. Therefore, there is no “rank injustice” nor is the status quo manifestly unfair. There is no objective defect in the prior treatment of quasi-community property which makes the retroactivity component unimportant in the overall statutory scheme.

2. Reliance and its Legitimacy

The California Supreme Court’s test requires that reliance on the property interest and its legitimacy be low in comparison to the state interest served by the retroactive legislation.

In the case of these statutes, by contrast, the reliance on the

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64. *In re Marriage of Lucas*, 27 Cal. 3d 808, 614 P.2d 285, 166 Cal. Rptr. 853 (1980).
65. *Fabian*, 41 Cal. 3d at 448-49, 715 P.2d at 258, 224 Cal. Rptr. at 338.
66. See *Addison*, 62 Cal. 2d 558, 399 P.2d 897, 43 Cal. Rptr. 97 (1965); *In re Thornton’s Estate*, 1 Cal. 2d 1, 33 P.2d 1 (1934).
property right is high. The courts have found that quasi-community property rights are vested rights.\(^6\) When property rights are vested, the person holding title to the property relies on the fact that he or she cannot be deprived of those rights without due process of law. In the past, the California courts have consistently and unequivocally held that quasi-community property is to be treated as the separate estate of the spouse holding title until death or divorce. The reliance on this consistent and unchanging position is indeed great and legitimate. The highest court in California has insisted upon this position since the early days of its history. The courts have thwarted all efforts by the California Legislature to abrogate these rights by striking down as unconstitutional any such legislation.\(^8\) Due to this legitimate reliance, this prong of the retroactivity analysis cannot be met.

IV. Proposed Amendments

This section will discuss the less burdensome alternatives which are available to the Legislature that both meet the policy goals announced by the Law Revision Commission and avoid the constitutional and policy infirmities present in the current statutes.

A. Text of Proposed Statute

California Civil Code section 5120.120 is amended to read:

(a) The following property shall be subject to liability for debts incurred by a member of the community:

- (1) the community property;
- (2) the separate property of a spouse who is personally liable for the debt;
- (3) the “quasi-community” property estate of any spouse personally liable for debt;
- (4) property which was classified as community property in another community property state; and
- (5) the “quasi-community” property of the non-debtor spouse to the extent that the acquisition of credit benefits the community.

(b) There is a presumption affecting the burden of proof that debts incurred by either spouse during marriage for consideration benefit the community.

(c) The presumption is rebuttable by the spouse contesting the

\(^6\) Addison, 62 Cal. 2d 558, 399 P.2d 897, 43 Cal. Rptr. 97 (1965); Thornton’s Estate, 1 Cal. 2d 1, 33 P.2d 1 (1934).

\(^8\) See supra section II.
liability of his/her "quasi-community" estate.

(d) Whether the debt incurred, benefits the community is a question of fact. The contesting spouse must show by a preponderance of the evidence that the debt did not benefit the community.

(e) The definition of "benefit to the community" within the meaning of this section is the same as that found in California Civil Code section 4800(d).

(f) This section applies to debts incurred on or after the effective date of this statute.

B. Advantages of the Proposed Statute

The proposed amendment to section 5120.120 provides that quasi-community property is liable only for the separate debts incurred by the spouse holding title to the quasi-community property and for debts beneficial to the community incurred by either spouse. This limitation on liability would be less onerous because the spouse with title to the property would be guaranteed a benefit. The title-holding spouse can encumber his or her quasi-community property or the non-title-holding spouse can encumber the other's quasi-community property; either way, the title-holder benefits. As the statute now stands, separate debts of the non-title holding spouse can be satisfied from the quasi-community fund of the nondebtor spouse. The nondebtor spouse is not guaranteed any benefit in exchange for the liability of his or her property.

California Civil Code section 4800(d) makes a distinction at dissolution as to whether a specific debt benefits the community. Debts incurred which do not benefit the community are to be assigned without offset to the spouse who incurred those debts. Consequently, there is already a provision built into the community property statutes which discriminates and finds important the distinction between debts that benefit the community and those that do not.

The proposed amendment to section 5120.120 would satisfy the state interest announced by the Legislature. The proposed statute would provide for the sharing of marital assets and liabilities by making the quasi-community property liable for community debts. The quasi-community property can be attached for all debts which are of benefit to the community and all debts for which the title-
holding spouse is personally liable.

The proposed statute also would provide equal access to credit for spouses because each can pledge quasi-community property for the repayment of debts incurred for the benefit of the community. Each spouse has the ability to receive credit based on his or her separate estate, the community estate, and the quasi-community estate to the extent that the credit is for the benefit of the community.

Amended section 5120.120 would also protect the rights of creditors by providing a greater base of assets from which they may satisfy debts, but not at the expense of the non-debtor spouse's ownership rights. The section gives creditors rights in property which, in all fairness, should be liable for the debt, and the section saves the creditor from having to make an expert determination of the classification of marital property.

The proposed statute represents a compromise between the old position, which did not allow creditors access to the quasi-community property, and the current statute which exposes the quasi-community estate to liability for all debts for which the community property is liable.

In addition, the proposed amendment to section 5120.120 would not violate the due process clause. The proposed amendment would guarantee the title holding spouse a benefit in exchange for his/her property's exposure to liability. His/her "quasi-community property" estate would be liable only for debts which he or she, as title-holding spouse, should be liable. The proposed section would not expose his/her property to liability for the separate debts of the other spouse. Amended section 5120.120 provides liability only for those debts from which the title holding spouse has directly or indirectly benefitted. Therefore, there is no "taking" of his/her property.

Although the proposed statute would subordinate the rights of the non-debtor spouse to those of the creditor, the new section allows this result only when it is fair and equitable. The community and the title-holding spouse have received value through the extension of credit. The non-debtor spouse's rights are not "subordinated" in the strict sense. The non-debtor spouse is only required to repay a debt for which he is morally, and now, legally liable. If he were not required to repay the creditor, the community could hide behind the title of the property to shield it from a creditor's attack. This would be an inequitable and unfair result. It would primarily burden the creditors, and would also injure society by potentially creating higher interest rates and consequent difficulties in obtaining credit.

The proposed amendment to section 5120.120 would also avoid
the major problem in Paley. In Paley, the crux of the difficulty was that the predeceased wife attempted to take her husband's property and give it away by will. The transfer was purely gratuitous providing the community with no benefit. The deceased wife attempted to divest her living spouse of the enjoyment of his property. This proposal provides that the quasi-community property is liable only when there is consideration for the title-holding spouse's liability. The amendment would not allow the debtor spouse to gratuitously transfer the property without benefit to the community, and the proposed section does not make the non-debtor spouse liable for the separate debts of the debtor spouse.

Therefore, the compromise suggested above is sound from the standpoint that the proposal would satisfy the policy goals, but would not unconstitutionally take the non-debtor spouse's property.

V. Reconciliation of the Policy Objectives

The major policy objective of the debt collection statutes is to provide for the rights of creditors in community property. The statutes are meant to provide the creditor with certainty when dealing with married couples. The proposed amendments to the statutes would continue that premise but would balance the rights of creditors with the property rights of the spouses.

The amended statute would provide creditors with rights in the community property but would not wholly deprive the community members of their individual property rights. The proposed statute would allow creditors to rely on legitimate expectations that community property, and to some extent quasi-community property, will be available to satisfy debts. Neither proposed statute would displace a creditor's rights in order to enhance the rights of the community member.

In addition, the proposed statute meets the policy objectives enunciated by the current statutes. The amended section 5120.120 would provide for the protection of California creditors as it would expose a greater base of assets to liability for debt collection purposes. The proposed section would provide for the sharing of community assets and liabilities between the spouses as the amended section would make the non-debtor spouse's "quasi-community" estate liable for debts from which he or she directly benefits. Proposed section 5120.120 would also enhance the credit opportunities for the non-title holding spouse by allowing him or her to encumber the "quasi-community property" of the other spouse to the extent that the debt benefits the community.
VI. CONCLUSION

Providing creditors with rights in community property is an important legislative goal, but that goal must be weighed against the property rights of the spouses. The California Law Revision Commission's purpose in advocating the enactment of sections 5120.020 and 5120.120 was to enhance the rights of creditors in marital property and to encourage financial equality between the spouses. Prior to the enactment of this section, quasi-community property was treated as separate property and, therefore, not liable for community debts.

Sections 5120.120 and 5120.020 impact due process rights and present important policy concerns. These problems can be remedied by enacting the proposed amendments to the sections. Amending section 5120.120 to expose quasi-community property to liability only if the debt is a benefit to the community avoids the due process problems of the current statute by providing the title-holding spouse with consideration in exchange for the liability of his property.

The amendment represents a compromise between the polar positions of the old and current statutes. The proposed amendment to the statute enacts the spirit of the policy goals, avoids the constitutional infirmities present in the current statute, and does not defeat legitimate property interests of the community members or creditors.

APPENDIX

In order to provide a frame of reference for the two statutes, it is helpful to examine the provisions of the entire sequence of debt collection statutes enacted in 1984.

A. Liability of Community Property: Section 5120.110

Cal. Civ. Code § 5120.110 provides:

(a) Except as otherwise expressly provided by statute, the community property is liable for a debt incurred by either spouse before or during marriage, regardless of which spouse has the management and control of the property and regardless of whether one or both spouses are parties to the debt or to a judgment for the debt.

(b) The earnings of a married person during marriage are not liable for a debt incurred by the person's spouse before marriage. After the earnings of the married person are paid, they remain not liable so long as they are held in a deposit account in which the person's spouse has no right of withdrawal and are
uncommingled with other community property, except property insignificant in amount. As used in this subdivision, “deposit account” has the meaning prescribed in Section 9105 of the Commercial Code, and “earnings” means compensation for personal services performed, whether as an employee or otherwise.

This section makes community property liable for premarital debts of either spouse. However, the earnings of the non-debtor spouse may be shielded under the new statute only by deposit in a separate account. This narrows the protection of the non-debtor spouse. Formerly, the non-debtor spouses were protected to the extent that property could be traced to his or her earnings.

B. Liability of Quasi-Community Property: Section 5120.120

This section is analyzed in detail in the text.

C. Liability of Separate Property: Section 5120.130

CAL. CIV. CODE § 5120.130 provides:

(a) The separate property of a married person is liable for a debt incurred by the person before or during the marriage.

(b) Except as otherwise provided by statute:

(1) The separate property of a married person is not liable for a debt incurred by the person’s spouse before or during a marriage.

(2) The joinder or consent of a married person to an encumbrance of community property to secure payment of a debt incurred by the person’s spouse does not subject the person’s separate property to liability for the debt unless the person also incurred the debt.

This section clarifies the liability of a spouse’s separate property for debts of the community. Generally, only personal debts may be satisfied from one’s separate estate. Therefore, the debts of the other spouse, incurred before or during marriage, may not be satisfied from the separate property of the non-debtor spouse.

D. Liability for Necessaries: Section 5120.140

CAL. CIV. CODE § 5120.140 provides:

(a) Notwithstanding the provisions of Section 5120.130, a married person is personally liable for the following debts incurred by the person’s spouse during marriage:
(1) A debt incurred for necessaries of life of the person’s spouse while the spouses are living together.

(2) Except as provided in Section 5131, a debt incurred for common necessaries of life of the person’s spouse while the spouses are living separately.

(b) The separate property of a married person may be applied to the satisfaction of a debt for which the person is personally liable pursuant to this section. If the separate property is so applied at a time when nonexempt community property is available but not applied to the satisfaction of the debt, the married person is entitled to reimbursement to the extent the property was available.

This new section resolves some of the ambiguities surrounding former California Civil Code Section 5121’s requirement that the non-debtor spouse’s separate property is liable only for community necessaries. The new statute makes the non-debtor spouse liable for the necessaries of life while the spouses are living together and for common necessaries of life while the spouses are living separate and apart without a formal agreement regarding the payment of expenses.

However, California Civil Code Section 5131, which protects a married person’s separate estate from liability for common necessaries of life when the parties are living separately by agreement, is unaffected by the new statute. The new section exposes the married person’s assets to liability without even making him or her a judgment debtor as required by former section 5121.

E. Liability for Support Obligation: Section 5120.150

CAL. CIV. CODE § 5120.150 provides:

(a) For the purpose of this chapter, a child or spousal support obligation of a married person that does not arise out of the marriage shall be treated as a debt incurred before marriage, regardless whether a court order for support is made or modified before or during marriage.

(b) If community property is applied to the satisfaction of a child or spousal support obligation of a married person that does not arise out of the marriage, at a time when nonexempt separate income of the person is available but is not applied to the satisfaction of the obligation, the community is entitled to reimbursement from the person in the amount of the separate income, not exceeding the community property so applied.
Nothing in this section limits the matters a court may take into consideration in determining or modifying the amount of a support order, including, but not limited to, the earnings of the spouses of the parties.

The Legislature repealed California Civil Code sections 5127.5 and 5127.6 which limited the availability of community property for support obligations of children and former spouses. The new section clearly identifies a child or spousal support obligation as a prenuptial debt for which separate property is primarily liable. The Law Revision Commission felt that the old law was inequitable because it did not give children and former spouses the same rights as creditors in the community property. 17 CAL. L. REVISION COMM’N. REPORTS 19 (1984).

F. Liability of Property after Division: Section 5120.160

Cal. Civ. Code § 5120.160 provides:

(a) Notwithstanding any other provision of this article, after division of community and quasi-community property pursuant to Section 4800:

(1) The separate property owned by a married person at the time of the division and the property received by the person in the division is liable for a debt incurred by the person before or during marriage and the person is personally liable for the debt, whether or not the debt was assigned for payment by the person’s spouse in the division.

(2) The separate property owned by a married person at the time of the division and the property received by the person in the division is not liable for a debt incurred by the person’s spouse before or during marriage, and the person is not personally liable for the debt, unless the debt was assigned for payment by the person in the division of the property. Nothing in this paragraph affects the liability of property for the satisfaction of a lien on the property.

(3) The separate property owned by a married person at the time of the division and the property received by the person in the division is liable for a debt incurred by the person’s spouse before or during marriage, and the person is personally liable for the debt, if the debt was assigned for payment by the person in the division of the property. If a money judgment for the debt is entered after the division, the property is not subject to enforcement of the judgment and the judgment may not be enforced against the married person, unless the person is made
a party to the judgment for the purpose of this paragraph.

(b) If property of a married person is applied to the satisfaction of a money judgment pursuant to subdivision (a) for a debt incurred by the person that is assigned for payment by the person's spouse, the person has a right of reimbursement from the person's spouse to the extent of the property applied, with interest at the legal rate, and may recover reasonable attorney's fees incurred in enforcing the right of reimbursement.

The new section reverses prior case law which permitted a creditor to obtain payment for a debt by attaching the former community property distributed to the non-debtor spouse. Under the new section, a creditor may satisfy his/her debt only from property distributed to the debtor spouse—rather from any traceable former community property.

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