

***“SHE GOT THE GOLDMINE, I GOT THE SHAFT!”***

***Marital Liability Between Spouses Including  
Responsibility For Child’s Liability***

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**Chapter 15**

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## “SHE GOT THE GOLDMINE, I GOT THE SHAFT!”

### Marital Liability Between Spouses, Including Responsibility For Child’s Liability

#### I. INTRODUCTION

##### A. Scope

This article is a discussion of the potential liabilities spouses may be exposed to in divorce litigation, including the potential liabilities of the parties’ children. Being able to identify the various types of liabilities and the characterization of the property that may be liable to satisfy the liability is crucial to effective representation of any client in divorce. A family law practitioner cannot begin to address a division of the marital assets without a complete understanding of the liabilities of the parties, both individually and as a marital unit. Some liabilities attach to the person; others to specific property; while others attach to both. A savvy and creative attorney can craft obligations in the Final Decree of Divorce that can create post-divorce obligations from one spouse to the other.

##### B. Sources and Acknowledgments

This author expressly appreciates the resources and previous compilations made available on this potentially problematic area of family law practice. For additional reading on this subject, the following articles are recommended reading: *How To Address Liabilities In Divorce*, by Randall B. Wilhite, presented at the 22<sup>nd</sup> Annual Marriage Dissolution Institute, May 1999; *Insolvency, Debts, and Liabilities: Splitting Them Up the Texas Way—How to Live Well On Other People’s Money*, by John Schorsch, Jr. and Michael P. Hutchens, presented at the University of Houston Family Law Practice Institute, 1999; *Liability of Parents For Conduct of Their Child Under Section 33.01 of The Texas Family Code: Defining the Requisite Standards of ‘Culpability,’* by L. Wayne Scott, 20 St. Mary’s L.J. 69 (1988); *Marital Liability in Texas...Till Death, Divorce, or Bankruptcy Do They Part*, a collaborative article written by Thomas Featherston, Jr. and Lynda S. Still published in the Baylor Law Review, Winter 1992; *Your Client’s Legal Responsibility for Her or His Spouse’s And Child’s Debts and Liabilities During Marriage and After Divorce*, by James

W. Paulsen, presented at the Advanced Family Law Course, August 1994; *Marital Liabilities*, by B.F. Pennypacker, III, presented at the Marriage Dissolution Institute, May 1993; Thomas J. Purdom’s *Marital Liabilities*, presented at the Advanced Family Law Course in August 1991; and a Thomas M. Featherston, Jr. and Amy Douthitt’s article, *Changing the Rules by Agreement: The New Era In Characterization, Management, and Liability of Marital Property*, 49 Baylor L. Rev. 271 (1997).

#### II. SPOUSAL LIABILITY DURING MARRIAGE

The statutory rules for marital liabilities are set forth in the Texas Family Code Chapter 3, Subchapter C. Unlike assets, which are classified as either separate property or community, liabilities are not subject to such classifications. The Family Code distinguishes between a spouse’s personal liability for a debt and the liability of assets to satisfy the debt. The marital property liability principles set forth in the Family Code do not substitute the traditional principles of liability. Many spouses will have direct personal liability for an obligation based upon traditional principles of law, which have nothing to do with the marital relationship between the spouses. However, the situation that most family law practitioners face is understanding and being able to utilize to their client’s advantage the circumstances under which the client’s interest in any asset may be used to satisfy the debt(s) of the other spouse.

##### A. Personal Liability of spouses

###### 1. Statutory Authority

The Texas Family Code, Section 3.201 describes spousal liability as follows:

###### § 3.201 Spousal Liability.

- (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 person; or
  - (2) the spouse incurs a debt for necessities as provided by Subchapter F, Chapter 2.
- (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.

TEX. FAM. CODE ANN. §3.201

## 2. Interpretation and Application of §3.201

Section 3.201, formerly codified at 4.031, clarifies misconceptions developing in the case law dealing with the issue of “community debt.” This section provides statutory guidelines under which a spouse is held personally liable for the other spouse’s debts. One commentator to section 3.201 has noted that:

This section attempts to destroy the amorphous notion of “community liability” or “community debt.” Since 1967 it has been the intent of the statutes in effect that one spouse is not personally liable for the debts of the other spouse, except when the other spouse was acting as an agent or incurring a debt for necessities. The concept of personal liability must be distinguished from the liability of property, both community and separate, which may be subject to execution depending upon the type of obligation. This section attempts to clearly delineate these principles of non-liability, and expressly provides that the marriage relationship alone does not create a basis for personal liability. The statute is specifically intended to clarify the holding in *Cockerham v. Cockerham*, 527 S.W.2d 162 (Tex. 1975).

Sampson & Tindall’s TEX. FAM. CODE ANN., Comment to Section 3.201.

## 3. The Cockerham Decision and “Community Debt”

The Texas Supreme Court’s opinion in *Cockerham* introduced the concept of “community debt” by stating 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 that the creditor agreed to look solely to the separate estate of the contracting spouse for satisfaction.” 527 S.W.2d 162, 171 (Tex. 1975). The *Cockerham* decision also appeared to extend the circumstances under which one spouse could be personally liable for the debts of the other spouse by the “totality of circumstances test.” *Id.* at 171. As pointed out in the comment to

Section 3.201, the enactment of the Texas Family Code Section 3.201 effectively eliminates the concept of “community debt “ from the marital liabilities analysis.

In 1993, B.F. Pennypacker expressed the expectation that since the *Cockerham* theory of “community debt” is totally contrary to the now Section 3.201, “case law in this area should be virtually non-existent in the future.” Pennypacker, *Marital Liabilities, Marriage Dissolution*, Section T at 3 (1993). In 1994 James Paulsen ran an experiment to see how well things were working. He found that as of August 1994, the phrase “community debt” has been used in 42 decisions, which was down from 52 decisions in the 6-½ years preceding enactment of this section on November 1, 1987. Paulsen, *Your Client’s Legal Responsibility for Her or His Spouse’s and Child’s Debts and Liabilities During Marriage and After Divorce*, Advanced Family Law Course, Section G at 10 (1994). In preparing for this article’s first publication for the 24<sup>th</sup> Annual Advanced Family Law Course this experiment was updated to find that as of mid June of 1998, the term “community debt” had been used in 23 reported cases since 1993. Another update for this article’s publication revealed only 13 reported cases using the term “community debt” since mid-June of 1998, of which three of those cases citing the term were in probate scenarios.

## 4. Agency Relationship Between the Spouses

An “agent” is one who is authorized by another to transact business for the principal; the relationship is a consensual one between two parties by which one party acts on behalf of the other, subject to the other’s control. *Bhalli v. Methodist Hosp.*, 896 S.W.2d 207 (Tex. App.—Houston [1<sup>st</sup> Dist.] 1995, writ denied). An agency relationship between the spouses will create personal liability for both spouses. Therefore, one spouse may be personally liable for the acts of the other spouse under the doctrines of *respondeat superior*, principal/agent relationship and joint enterprise. The elements of a “joint enterprise” are:

- an agreement, express or implied, among the members of the group;
- a common purpose to be carried out by the group;
- a community of pecuniary interest in that purpose, among the members; and,

- an equal right to voice in the direction of the enterprise, which gives an equal right of control.

*Shoemaker v. Estate of Whistler*, 513 S.W.2d 10, 15 (Tex. 1974).

However, the marriage relationship alone is not sufficient to generate vicarious liability, without the presence and proof of the elements of joint enterprise, a theory of negligence by one spouse cannot be imputed to the other for liability purposes. For example, in *Rhea v. Williams*, 802 S.W. 2d 118 (Tex. App.—Forth Worth 1991, write denied), a jury found that the husband and wife were engaged in a “joint enterprise” and thus the negligence of the wife/driver was imputed to her passenger/husband and deprived him of any recovery for personal injuries sustained by him. The Court in *Rhea* emphasized “the finding of joint enterprise did not stem from the Rhea’s marital relationship, but upon specific facts of this case....” *Rhea v. Williams*, 802 S.W.2d at 121.

Also, in *Carr v. Houston Business Forms, Inc.*, 794 S.W.2d 849, 852 (Tex. App.—Forth Worth 1991, writ ref’d n.r.e.), the Court held it was reversible error for the trial court to refuse to submit jury instructions that tracked the language of the Texas Family Code Section 3.201 in a case which involved the question of an ex-wife’s personal liability for debts incurred by the husband during the marriage.

## 5. The “Necessaries” Doctrine

### a. In general.

According to statute, each spouse has the duty to support the other spouse and each spouse has a duty to support his or her child for as long as that child is an unemancipated minor and thereafter until the child graduates from high school. TEX. FAM. CODE ANN. §§ 2.501, 151.003(b). A spouse who fails to discharge the duty of support is liable to any person who provides necessities to those to whom support is owed.

Whether a liability incurred by a spouse is for necessities 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, [1<sup>st</sup> Dist.] 1961, no writ). Minimal necessities 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” can include items such as cosmetics or a piano. *Gabel v. Blackburn Operating Corp.*, 442 S.W.2d 818, 820 (Tex.Civ.App.—Amarillo 1969, no writ); *Lee v. Hall Music Co.*, 35 S.W.2d 685 (Tex. 1931).

A person who has provided “necessaries” to one spouse/child can recover their value from the other spouse only by establishing that the other spouse failed to discharge his or her duty of support by not providing those necessities his/herself. TEX. FAM. CODE ANN. § 2.501(b) and TEX. FAM. CODE ANN. §151.003(c); See *Marynick v. Bockelmann*, 773 S.W.2d 665, 671 (Tex.App.—Dallas 1989), *rev’d on other grounds*, 788 S.W.2d 569 (Tex. 1990).

### b. Necessaries Furnished to a Child.

A parent who fails to discharge the duty of support of his or her child is liable to any person who provides necessities to the child to whom support is owed. TEX. FAM. CODE ANN. § 4.02. If a parent refuses or neglects to provide necessities and they are supplied by a third person, the law implies a promise on the part of the parent to pay for them. *Hartmon v. Chumley*, 266 S.W. 444 (Tex. Civ. App.—Waco 1924); *Sanger Bros. v. Trammell*, 198 S.W. 1175 (Tex. Civ. App.—Forth Worth 1917); *Snell v. Ham*, 151 S.W. 1077 (Tex. Civ. App.—Amarillo 1912, writ dism’d w.o.j.). The person furnishing the necessities may sue and recover their value from the parent. *Gully v. Gully*, 231 S.W. 97 (Tex. 1921); *Lawrence v. Cox*, 464 S.W.2d 674 (Tex. App.—Waco 1971, writ dism’d w.o.j.); *Heard v. Bauman*, 443 S.W.2d 715 (Tex. 1969), *aff’d* 443 S.W.2d 715 (Tex. 1969); *Smith v. Waller*, 422 S.W.2d 189 (Tex. App.—Forth Worth 1967, writ ref’d n.r.e.); *Dilger v. Dilger*, 271 S.W.2d 169 (Tex. Civ. App.—Amarillo 1951); *Maxwell v. Maxwell*, 204 S.W.2d 32 (Tex. Civ. App.—Amarillo 1947, writ ref’d n.r.e.); *Hooten v. Hooten*, 40 S.W.2d 52 (Tex. 1931).

## 6. Direct Liability Based on Traditional Law



Principles

The relevant provisions in the Family Code discuss only the extent to which a spouse may be personally responsible for the liabilities of the other spouse based solely upon the parties' marital status. Do not overlook the fact that a spouse may have direct personal liability for an obligation based upon traditional contract and tort principles. The Business and Commerce Code provides that "A person is not liable on an instrument unless the person signs the instrument." TEX. BUS. & COM. CODE ANN. § 3.401. Therefore, if both spouses sign on a promissory note, both spouses are jointly obligated for reasons wholly independent of their marriage relationship.

7. Statutory Liability of Parent For Child

A parent or other person who is responsible for the control and reasonable discipline of a child is liable for any property damage proximately caused by the negligent conduct of the child, if the conduct is reasonably attributable to the negligent failure of the parent or other person to exercise that duty, or the willful and malicious conduct of a child who is at least 12 years of age but is under 18 years of age. TEX. FAM. CODE §§ 41.001(1) and (2). The liability of a parent for a child's tortious conduct that inures property is more theoretical than real; while a parent can be held liable for up to \$25,000 in damages for negligent or malicious acts of the child, very few instances of a court actually holding a parent liable have been reported.

A comprehensive analysis of parental liability for the torts of children can be found in the article entitled *Liability of Parents For Conduct of Their Child Under Section 33.01 of The Texas Family Code: Defining the Requisite Standards of 'Culpability,'* by L. Wayne Scott, 20 St. Mary's L.J. 69 (1988).

8. Parent's Liability To a Child

An unemancipated minor child may maintain an action for damages against the parent for a willful or malicious personal tort. *Felderhoff v. Felderhoff*, 473 S.W.2d 928 (Tex. 1971). By the commission of willful, malicious, and intentional wrongs against a child, the parent has abdicated or abandoned parental responsibilities and thereby subjects him/herself to liability. *Id.* There is no parental immunity from suit, if the child is of legal age. *Wallace v.*

*Wallace*, 466 S.W.2d 416 (Tex. Civ. App.—Eastland 1971, writ dismissed).

A child, however, does not have an action against the parent for ordinary negligence, where the parental act involves the reasonable exercise of parental authority or ordinary parental discretion with respect to provision for care and necessities of the child. *Felderhoff, supra*. Parental duties, in this respect, include the provision of shelter, food, schooling, family chores, medical care and recreation. *Id.* Acts that go beyond this authority and discretion will provide sufficient basis for an action for damages. *Id.*

**B. Liability of Marital Property**1. Rules of Property Management

It is important to have a clear understanding of the rules relating to the management of marital property before addressing the rules of any potential liability, as the two issues are obviously correlative.

The Texas Family Code specifies the management powers each spouse has over the marital assets. As would be expected, each spouse has sole management, control and disposition over his/her separate property. TEX. FAM. CODE ANN. § 3.101. Furthermore, each spouse has sole management, control and disposition over the community property he/she would own if not married, including wages, income from separate property, monetary recoveries for personal injuries and income from that spouse's community property subject to his/her sole management and control. TEX. FAM. CODE ANN. § 3.102(a).

If the spouses commingle their respective sole management community property, then the mixed or combined community property becomes subject to the joint management of the spouses. TEX. FAM. CODE ANN. § 3.102(b). Additionally, except for the property designated as solely-managed community property in the Texas Family Code Section 3.102(a), all other community property is subject to both spouses' joint management, control and disposition. TEX. FAM. CODE ANN. § 3.102(c).

2. Statutory Authority

Once the practitioner has addressed whether an asset is husband's sole management community property, husband's separate

property, wife's sole management community property, wife's separate property or the spouses' joint management community property, the practitioner can look to the Texas Family Code Section 3.202 to determine liability.

Texas Family Code Section 3.202 provides:

**§ 3.202 Rules of Marital Property Liability.**

- (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.

TEX. FAM. CODE ANN. § 3.202.

**3. Interpretation and Application of § 3.202**

While the Texas Family Code Section 3.201 establishes the limitations of personal liabilities of spouses, Section 3.202 provides rules for the satisfaction of a liability against marital property once the obligation is established against one or both spouses. Although a spouse may not be personally liable for an obligation, the "innocent" spouse may suffer the loss of community property due to the other spouse's liability.

Liabilities are classified according to whether they are tortious or non-tortious, whether they were incurred before the marriage or after the marriage and whether both spouses are personally liable for the obligation. As a general rule, liability follows management, so that all of the property which that spouse has a right to manage is subject to all of his/her liabilities. The Family Code makes an exception to this general rule concerning tort liability. The entire community estate, including the non-tortfeasor spouse's sole management community property, is subject to all of his/her spouse's tort liabilities that were incurred during the marriage. There is no clear reason why this tort exception exists. The best explanation found is possibly from James W. Paulsen's previously referenced article in which he speculates that the legislature has an "undisclosed public policy designed to provide economic encouragement for making one's spouse a better person, a more careful driver, and so forth." Paulsen, section G at 9. Whatever the reason for this exception, tort liabilities are treated differently than other obligations and do not follow the general rule.

**4. Multi-Step Analysis**

Professor Thomas Featherston has advanced a multi-step analytical process to determine which assets are subject to a particular debt. First, the practitioner must determine whether the debt was incurred solely by the husband, solely by the wife or jointly by both husband and wife. Secondly, determine whether the debt was incurred prior to the marriage. Thirdly, classify the debt as either tortious or non-tortious in nature. Finally, determine whether there are any other substantive rules of law that would make one spouse personally liable for the debts of the other spouse, such as agency or necessities. Featherston and Still, *Marital Liability in Texas... Till Death, Divorce, or Bankruptcy Do They Part*, 44 BAYLOR LAW REV. 1, 14, (1992). Once these issues have been addressed, the practitioner should then review Section 3.202 of the Texas Family Code and determine which of the marital assets are subject to a particular debt.

**5. Summary of Liabilities**

Under the legislative scheme of the Texas Family Code, there are five types of marital property (based upon management):

- Separate property of Husband;
- Separate property of Wife;
- Community property subject to Husband’s sole management and control;
- Community property subject to Wife’s sole management and control; and
- Jointly managed community property.

A summary of liabilities that can attach to each type of marital property is as follows:

a. Liability of Husband’s Separate Property

A Husband’s separate property is only liable for:

- Husband’s non-tortious liabilities during marriage
- Husband’s premarital liabilities;
- Husband’s tortious liabilities during marriage;
- Husband’s federal tax liabilities;
- Joint liabilities of Husband and Wife;
- Liabilities incurred for Wife and children’s necessities; and
- Liabilities incurred by Wife as agent of Husband.

b. Liability of Wife’s Separate Property

A Wife’s separate property is only liable for:

- Wife’s non-tortious liabilities during marriage
- Wife’s premarital liabilities;
- Wife’s tortious liabilities during marriage;
- Wife’s federal tax liabilities;
- Joint liabilities of Husband and Wife;
- Liabilities incurred for Husband and children’s necessities; and
- Liabilities incurred by Husband as agent of Wife.

c. Liability of Husband’s Solely Managed Community Property

A Husband’s solely managed community property is liable for:

- Husband’s premarital liabilities;
- Husband’s tortious and non-tortious liabilities during marriage;
- Wife’s tortious liabilities during marriage;
- Joint liabilities of Husband and Wife;
- Liabilities incurred for Wife and children’s necessities;
- Liabilities incurred by Wife as agent of Husband; and
- Federal taxes incurred by Husband and Wife.

d. Liability of Wife’s Solely Managed Community Property

A Wife’s solely managed community property is liable for:

- Wife’s premarital liabilities;
- Wife’s tortious and non-tortious liabilities during marriage;
- Husband’s tortious liabilities during marriage;
- Joint liabilities of Husband and Wife;
- Liabilities incurred for Husband and children’s necessities;
- Liabilities incurred by Husband as agent of Wife; and
- Federal taxes incurred by Husband and Wife.

e. Liability of Jointly Managed Community Property

Jointly managed community property is liable for:

- Wife’s premarital liabilities;
- Husband’s premarital liabilities;
- Wife’s tortious and non-tortious liabilities during marriage;
- Husband’s tortious and non-tortious liabilities during marriage;
- Joint liabilities of Husband and Wife; and,
- Federal taxes incurred by Husband and Wife.

### 6. Creditor's Goal

When a creditor is attempting to attach the assets of the “innocent” spouse to satisfy a non-tortious liability incurred by the other spouse during marriage, the creditor will be successful if it can prove either:

- The “innocent” spouse is personally liable for the debt. If the spouse is directly liable, then all of the non-exempt assets of the “innocent” spouse are subject to the liability; or
- The non-exempt asset is jointly managed community property, rather than solely managed community property. Jointly managed community property is subject to all liabilities of either spouse.

In *Nelson v. Citizens Bank & Trust Co.*, 881 S.W.2d 128 (Tex. App.—Houston [1<sup>st</sup> Dist.] 1994, no writ), Mrs. Nelson won the battle but lost the war. Mrs. Nelson was successful when the Court of Appeals held that she was not personally liable for her husband's debt. However, her interest in the asset she was attempting to shield was jointly managed community property and thus, subject to execution to satisfy the debt of her husband.

An interesting case, which warrants reading along this vein is *Sprick v. Sprick*, 25 S.W.3d 7 (Tex. App.—El Paso, 1999). Mr. Sprick had a sole proprietorship and an old friend, who testified at the divorce trial that she had loaned him substantial funds, although the loan appeared not to “pass the smell test.” Nonetheless, the trial court found the debt to be a loan and Ms. Johnson to be a legitimate creditor. As such Mr. Sprick received the debt in the division, having the appearance of a hugely disproportionate share of the estate going to Ms. Sprick, above and beyond Ms. Sprick's allegations of fraud against the community. Of particular interest is the concurring opinion informatively penned by Justice Ann McClure, and to which this author directs the reader.

## III. CHANGING MARITAL PROPERTY LIABILITY BY AGREEMENT

### A. Liability Planning Tool

Pre-marital and marital agreements can be an effective liability planning tool as the parties are able to change the character of property by

agreement. Most people think of marital agreements and premarital agreements only in the context of divorce litigation or death. However, since parties can change the characterization of an asset by agreement, the property to which a creditor can satisfy a debt is affected. Through the use of a partition and exchange agreement, the parties can effectively create a “community free” marriage, thereby limiting the rights of creditors by insulating their separate property from the claims of the other spouse's creditors. However, if the debt is for “necessaries,” or if an agency relationship exists between the spouses, neither spouse can insulate their respective separate property from such debts.

For additional information on marital agreements, the reader is directed to Harry Tindall's article, *The Bermuda Triangle: Pre-nupts, Post-nupts and Partitions (How to Attack and Defend Pre- and Post Marital Agreements)*, located at Chapter 10 of this course book.

### B. Pre-Existing Creditor Caveat

A partition or exchange agreement is void with respect to the rights of pre-existing creditors whose rights are intended to be defrauded by it. TEX. FAM. CODE ANN. §4.106(a). Therefore, partition and exchange agreements are effective only as a liability planning tool before the liability is incurred.

For a comprehensive treatment of this subject, please see the article co-authored by Professor Featherston and Amy E. Douhitt, referenced in the acknowledgment section of this paper, and which provides a very thorough analysis of changing the marital property rules through the use of pre-marital and marital agreements.

## IV. TREATMENT OF LIABILITIES AT DIVORCE

### 1. Creditor's Rights Unaffected by Divorce

The divorce court can impose the responsibility for payment of liabilities as between the Husband or Wife. However, as far as the creditors are concerned, the court's apportionment of such debt does not shield the non-responsible spouse from the debts or obligations in which he/she is personally liable. See *Blake v. Amoco Federal Credit Union*, 900 S.W.2d 108 (Tex. App.—Houston [14<sup>th</sup> Dist.] 1995, no writ); *Stewart Title Co., v. Huddleston*, 598 S.W.2d 321, 323 (Tex. Civ. App.—San

Antonio), writ ref'd per curiam, 608 S.W.2d 611 (Tex. 1980). The divorce decree may only determine the liability for an obligation to third-party creditors as between the parties. The court does not have the power to diminish the rights of creditors to proceed against either or both spouses for the payment of obligations incurred during the marriage. Furthermore, the assets that could be used to satisfy a creditor's claim prior to divorce can still be reached by that creditor after divorce. *Anderson v. Royce*, 624 S.W.2d 621, 623 (Tex. App.—Houston [14<sup>th</sup> Dist.] 1981, writ ref'd n.r.e.); *Inwood National Bank of Dallas v. Hoppe*, 596 S.W.2d 183 (Tex. Civ. App.—Texarkana, 1980, writ ref'd n.r.e.).

## V. TEXAS UNIFORM FRAUDULENT TRANSFER ACT

Prior to advising the client about a property settlement agreement, the practitioner must keep in mind the provisions dealing with fraudulent transfers. A transfer of assets from one spouse to another pursuant to a divorce settlement may be set aside as being fraudulent as to both pre-divorce and post-divorce 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 agreeing to a divorce settlement.

The action to avoid and recover fraudulent transfers may be brought by a creditor or the trustee in a bankruptcy action. A property settlement agreement between spouses incident to a divorce may be difficult to show it was done with the intent to hinder, delay or defraud creditors. However, it is the constructive fraud section of the fraudulent transfer act, located at Section 24.006(a) of the Texas Business & Commerce Code, which can cause significant problems for the parties.

As to present creditors, the Texas Business & 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 was 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.

TEX. BUS. & COM. CODE ANN. § 24.006(a).

A transfer is fraudulent if it is made in exchange for less than reasonable equivalent value and the debtor was insolvent at the time of the transfer. 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.

## VI. BANKRUPTCY

### A. In General

The practitioner should always advise his/her client of the potential that the other spouse may file bankruptcy after the divorce. Liabilities assigned as part of the division of the community property are subject to discharge in bankruptcy if the debtor ex-spouse does not have the ability to pay the debt or if the benefit of discharging the debt to the debtor ex-spouse outweighs the detrimental consequences to the debtor's former spouse or child. 11 U.S.C. § 523(a)(15)(A) and (B)(1994). However, a debt to a former spouse or child cannot be discharged if it is a debt for alimony, maintenance or support of the spouse or child in connection with a divorce decree. 11 U.S.C. § 523(a)(5) (1979).

As they relate to family law, the most important changes to the Bankruptcy Code address the automatic stay, the priority of claims, the protection of liens, the dischargeability of certain obligations, and the avoidability of certain payments as preferences.

### B. Modification of Automatic Stay

The Bankruptcy Reform Act of 1994 modified the automatic stay provision to exclude proceedings to (1) establish paternity or (2) obtain alimony, maintenance or support orders from state courts. 11 U.S.C. § 362 (West 1996). Additionally, the collection of alimony, maintenance or support from property that is not property of the bankruptcy estate is also no longer prohibited by the automatic stay on a bankruptcy filing. *Id.* It is important to note, however, that the non-debtor spouse must still seek a modification of the stay from the bankruptcy court in order to pursue a division of the marital estate in state court.

### C. Superior Priority for Support Claims

Under the 1994 amendments, claims of a spouse, former spouse or child of the debtor for alimony, maintenance or support are given a

higher priority to the extent that they are placed ahead of the taxing authorities including the Internal Revenue Service. *Id.* As a practical matter, this change in priority provides the non-debtor spouse, former spouse or child with a significantly greater chance of collecting from the bankruptcy estate.

#### D. Judicial Liens

Under the 1994 Act, the debtor may no longer avoid judicial liens that were used to secure a debt to a spouse, former spouse or child of the debtor for alimony, maintenance or support of such spouse or child granted under a divorce decree, property settlement or other order of a court in accordance with state law. *Id.* §522. The creditor must be able to show that the lien was in fact used to secure one of the exempt liabilities and that liabilities designated as alimony, maintenance and support are actually in the nature of alimony, maintenance or support. The family law practitioner should detail and/or cross-reference the reasons for the lien in the divorce decree, property settlement or other order of the court sufficient to evidence the nature and basis for the lien. To the extent that the parties wish to create an alimony obligation, the lawyer should be very careful not to create a paper trail, in the context of divorce settlement negotiations, that in any way implies that the stream of alimony is no more than a *de facto* payout in consideration for the other spouse's interest in the community estate.

#### E. Exception to Discharge

The 1994 Act added a new exception to the discharge of certain debts. Debts owed to a spouse or former spouse, which were incurred in connection with a divorce or separation agreement or other order of the court, will not be dischargeable unless:

- The debtor does not have the ability to pay such a debt from future income or property not necessary to support the payments of the debtor and, if the debtor is engaged in a business for payment of necessary business expenditures; or
- The discharge of such debt will result in a benefit to the debtor that outweighs the detrimental

consequences to a spouse, former spouse or child of the debtor.

*Id.* §523(a)(15).

This exception to the discharge provisions of the Bankruptcy Code clearly provides a certain amount of protection to divorcing spouses who agree to lower alimony or take a lower percentage of the net marital estate in consideration for the other spouse taking a higher percentage of the marital debts supported by an indemnification clause.

A more in-depth coverage of insolvency and bankruptcy and its effect on marital property, refer to the article *When the Wolf's at the Door: Pending Insolvency and Its Effect on Divorce*, by Joseph A. Friedman, and located at Chapter 14 of your course materials. Also, Randall Wilhite's article, as referenced in the Acknowledgement section of this paper has extensive treatment of Bankruptcy and Divorce.

Included in the appendix are the forms necessary to request a stay, order a stay and to complaint disputing dischargeability.

#### VII. FEDERAL INCOME TAXES

Under current law, both spouses are jointly and severally liable for all of the taxes due on a joint return. If the spouses file separate income tax returns, then each spouse is to report one-half of his/her community income and one-half of the other spouse's community income. Spouses generally file joint returns because of the belief that the amount of taxes they will be required to pay will be significantly lower. However, in many situations the combined tax liability if each spouse files a separate return is not significantly different than if the spouses file a joint return. Even if there may be some tax savings to the parties as a whole, sometimes there is a significant diminished liability advantage to filing separate returns. It is generally better for your client to be liable for only one-half of the taxes than being jointly and severally liable for the entire tax liability. In all circumstances, however, the method of filing that benefits the client should be a determination made by and between the client and their personal tax representative.

#### VIII. DIVORCE DECREE DRAFTING CONSIDERATIONS

When negotiating a property division between the spouses, keep in mind the following:

#### A. Exempt Assets

One way to avoid creditors from attaching the assets awarded to your client in a divorce is to negotiate the settlement in such a way that your client is awarded the exempt assets, which may include the homestead. TEX. CONST. ART. XVI, § 50 and TEX. PROP. CODE ANN. § 41.001; TEX. PROP. CODE ANN. §§ 42.001, 42.002 (dealing with personal property); TEX. PROP. CODE ANN. § 42.0021 (regarding retirement benefits); TEX. PROP. CODE ANN. § 42.002(12) and TEX. INS. CODE ANN. § 21.22 (addressing insurance proceeds).

#### B. Indemnification

The property settlement agreement should contain indemnity provisions in the event that the assets of one spouse are taken to satisfy the debt of the other spouse. An indemnification clause is contractual in nature and is not enforceable by contempt. However, if the client is required to enforce an indemnity agreement, the client can be awarded a money judgment against the debtor spouse. The ability to collect on such a judgment will depend entirely upon the financial condition and exempt property status of the debtor spouse. To avoid the situation in which the client has an uncollectible money judgment, the practitioner should ensure that any debts assumed by the other spouse are adequately collateralized.

#### C. Security of Obligation

Whenever possible, secure any obligation owed to the client, as a receivable, in the decree. The trial court can impose equitable liens in combination with property awards or money judgments. See *McGoodwin v. McGoodwin*, 671 S.W.2d 880 (Tex. 1984); *Hanson v. Hanson*, 672 S.W. 2d 274 (Tex. App.—Houston [14<sup>th</sup> Dist.] 1984, writ dismissed).

For additional information on securing and enforcing the Judgment, the reader is directed to Mike Gregory's article, *Avoiding the Thorns While Picking the Roses: Enforcing, Securing and Clarifying Property Divisions*, located at Chapter 19 of your course book.

#### D. Statute of Limitations Considerations

It has been held that the two-year statute of limitations in Family Code Section 9.003 does not apply to agreements incident to divorce, which, if incorporated into the divorce decree, are governed by the ten-year statute of limitations governing the enforcement and revival of judgments. See TEX. CIV. PRAC. & REM. CODE ANN. §§ 31.006, 34.001; *Pettit v. Pettit*, 704 S.W.2d 921, 923-924 (Tex. App.—Houston [14<sup>th</sup> Dist.] 1986, writ refused n.r.e.). As a practical matter the family law practitioner should consider, whenever possible, incorporating the property settlement agreement into an agreement incident to divorce in order to take advantage of the longer statute of limitations.

Furthermore, if one spouse unconditionally assumes income tax liability for a specific year and that liability is significantly increased after an audit following divorce, the indemnified spouse should pay close attention to the statute of limitations in the event that the debtor/spouse fails to pay the newly determined tax debt.

#### IX. THE "MARSHALLING STATUTE"

The Family Code grants the court the discretion to determine the order in which marital assets can be used to satisfy a spouse's liability. TEX. FAM. CODE ANN. § 3.203(a). If the client is the "innocent" spouse who finds him/herself in the position in which his/her property is being attached, the "innocent" spouse can use this statute to his/her advantage and request that the Court determine the order in which property will satisfy the judgment. This statute requires that there be more than enough assets to satisfy the debt.

Section 3.203 of the Texas Family Code states:

##### § 3.203 Order in Which Property Is Subject to Execution.

(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.

TEX. FAM. CODE ANN. § 3.203.

Under §3.203 an “innocent” spouse can use the statute offensively and request that court require the depletion of the debtor/spouse's separate property before depleting the community estate in order to satisfy debts incurred by the other spouse. Alternatively, if the parties cooperate and present an agreed proposal to the court that provides for the disposition of assets and debts, they can maximize the value of the community estate while minimizing the marital debt burden.

## X. CONCLUSION

In nearly every case, the family law practitioner must deal with debts and liabilities, beginning in the initial interview with the client through the drafting of the decree. The goal of the practitioner should be to obtain the best possible net property award for the client. This requires the practitioner to educate her/himself and the client on the potential liabilities she/he or the community may be facing, and to fashion the most favorable shield to protect the client and the ultimate award of assets/liabilities.

To adequately protect a client with regard to outstanding debts and liabilities, it is vital that the attorney discover the identity of such debts and liabilities before entering into any agreements or proceeding to trial. The easiest method of discovering outstanding marital debts and liabilities is through discovery. Responses to carefully detailed interrogatories and requests for production should provide the requisite information in most divorce cases. However, in

cases where there is reason to believe that the other party is withholding information or is otherwise financially suspect, the attorney and client can and should take it upon themselves to initiate more extensive discovery such as depositions, third party depositions, and a request for an exchange of sworn inventory and appraisements. Additionally, the attorney and client should conduct their own investigation through alternative means.

Financial information is available from a wide variety of sources. For example, the client should personally request in writing their own updated credit report from the three major credit reporting agencies (TransUnion, TRW, and Equifax). The request should specifically ask for all information relating to the client individually as well as all information relating to any joint files under all possible names and titles. In cases where there is real property at issue, the client or attorney should conduct a lien search to determine if there are any outstanding liens against any property in which the client has or may have an interest.

The legislature has formulated a statutory scheme regarding marital liabilities set forth in the Texas Family Code. In many instances the “best” property division for the client may not necessarily call for obtaining the largest percentage of the total assets of the parties. If this is the sole objective, the end result can be quite costly to the client at a later date, when the client finds her/himself embroiled in litigation with creditors who are attempting to seize the valuable non-exempt assets awarded to the client in the decree. The practitioner should advise her/his client about the marital liabilities and their effect on the various assets of the spouses. Advising the client on how to “mine” successfully through the assets available for division, keeping in mind the rules of marital property liability, will help the client avoid the potential “shaft” that the client (and therefore his attorney!) may find himself otherwise tumbling towards.