TO LOVE, HONOR, CHERISH AND ACT AS A FIDUCIARY-- A FRIGHTENING NEW COMPONENT OF THE MARITAL COMPACT

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II. PURPOSE

As the common law evolved, new theories of recovery or responsibility developed which were not previously recognized. They evolved over many years to meet the changing needs of a changing and evolving society. In the modern era, such changes are often brought about not because of a need for a change in the social compact, but rather by a desire on the part of advocates to represent their clients more aggressively, and by a desire on the part of clients to be more aggressively represented. (This is sometimes technically referred to as "greed".) One of these new theories which is currently being advanced is that the manager of the community property somehow owes broad fiduciary duties to the non-managerial spouse. This theory is evidently premised on the fact that marriage is clearly a relationship in which the parties are expected to repose in each other special trust and confidence — the very essence of a fiduciary relationship — and therefore all aspects of their relationship are governed by heretofore unrecognized duties. The purpose of this paper is to explore and analyze the duties that the fiduciary relationship imposes upon the spouse who has the managerial authority over finances. The author apologizes in advance for the fact that the paper assumes that the husband is the manager of the money, and so uses the masculine pronoun. This decision is brought about by two factors which follow one from the other — (1) the constant use of "he or she" is not only distracting but wastes space and therefore trees; and (2) I would never be able to remember to use "she" consistently.

III. SCOPE

This article deals solely with the financial aspects of the fiduciary duties of the spouses one to the other. It makes no attempt to explore other issues of fidelity. (Government studies by Mr. Starr and analysis by the media seem to have explored those more than adequately, even *ad nauseam*). While I will examine in some detail the issue of fiduciary duty as it relates to duties owed to the community with respect to investment opportunities of the community, I will also explore other ramifications and logical(?) extensions of the fiduciary relationship theory, particularly as they may impact traditional estate planning techniques.

IV. OVERVIEWS

The problem and what ought to be the correct answer is set forth in summary below.

A. A General Statement of The Problem

As one family lawyer explains it, "If there is not sufficient property in existence, then my job is to create property." A corollary proposition which enables the accomplishment of the first is that, "Family law judges are in the business of 'doing right'." One of the "hot" techniques for creating property is to argue that there where the community property manager also has separate property, he has a fiduciary duty to invest the community property before he invests his separate property. Thus, if an investment opportunity comes along, the husband is not free to decide to invest his separate property rather than the community property, because to so decide would be a breach of his fiduciary duty. And if that is so, then even if there is no separate property, it would seem to follow that the same fiduciary duty existed with respect to his management of his special community. One real difficulty here, which will be explored in greater detail below, is that the special community property is really the property of the managerial spouse in which the other spouse has certain limited inchoate rights. How can a fiduciary duty be imposed upon the spouse who is managing his own money?

B. A Short Answer to the Contention

The imposition of the kind of fiduciary duties proposed would be a sea change in long standing Texas law. It would give rise to a whole new set of duties in the marital relationship, the consequences of which cannot be anticipated. The author believes that the relationship between the spouses with respect to the management of special community is wholly one of statute, with the judicial gloss concerning transfers in fraud on the community. No true fiduciary relationship exists with respect to the management of one

spouse's special community or that spouse's separate property. A recent Texas Supreme Court opinion, as well as long established case law, would seem to support this proposition. The reasons for this answer will be developed in the following sections. We begin with an examination of basic principles, and proceed from there to explore existing law applying those principles.

V. THE FAMILY CODE BASICS

The Texas Family Code provides a statutory basis for the managerial rights of the spouses, and certain financial obligations each to the other. Prior to the changes made by the legislature in 1967, the husband was the sole community manager, and each spouse had the right to manage such spouse's separate property. Since that time, the Family Code has recognized different managerial rights.

A. Managerial Rights

The managerial rights of the spouses during marriage are defined in Subchapter B of Chapter 3 of the Family Code. Each spouse has the right to manage that spouse's separate property. §3.101. As a general rule, community property is subject to the joint management of the spouses. §3.102(c). However, each spouse is entitled to the "sole management, control and disposition" of that spouse's community property "that the spouse would have owned if single." §3.102(a). That section then goes on to list examples (which I believe were meant to be inclusive rather than exhaustive): "(1) personal earnings; (2) revenue from separate property; (3) recoveries for personal injuries; and (4) the increase and mutations of, and the revenue from, all property subject to the spouse's sole management, control and disposition."

B. Support Obligations

Each spouse has the obligation to support the other. Family Code §2.501.

C. Division of Property on Divorce

Family Code §7.001 provides that the "estate of the parties" is to be divided in a manner that the court determines to be "just and right." While on its face, this would appear to apply to both community and separate property, the court has no authority to set aside the separate property of one spouse to the other. *Cockerham v. Cockerham,* 527 S.W.2d 162 (Tex. 1975). Of course, the court in its "just and right" division of the community property, may consider the separate property of the parties.

VI. THE FIDUCIARY DUTY BASICS

The concept of fiduciary duties has developed both in the common law and by statute. There is also confusion surrounding the concept of duties as contrasted with powers. Since there are no statutes which directly address the problems here, fiduciary duties between spouses, if any exist, must be found in the common law. Black's Law Dictionary defines "Fiduciary Relation" as "including both technical fiduciary relations and those informal relations which exist whenever one man trusts and relies upon another," citing *Peckham v. Johnson,* 98 S.W.2d 408 (Tex. Civ. App. — Fort Worth 1936), involving fiduciary duties among partners.

A. Who Are Fiduciaries?

It is clear that a fiduciary relationship may arise as a result of a formal arrangement, such as trustee or executor, or it may arise as a result of the relationship of the parties. There are many kinds of fiduciary relationships; *e.g.,* principal-agent; partners; familial relationships and even friendships.[1] Texas law even imposes fiduciary duties on a life tenant holding certain powers. Texas Property Code §5.009. Clearly, husband and wife have a fiduciary relationship.

B. Understanding the Difference Between Duties and Powers

A trustee may have broad powers, but the broad powers may be circumscribed by his duties. For

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[1] *See* Anderson, *The Wolf at the Campfire*: *Understanding Confidential Relationships,* 53 SMU Law Rev. 315 (Winter 2000).

example, in the investment area, the trustee may have broad powers to invest in any kind of investment whether authorized as a trust investment or not. However, unless the instrument specifically modifies the duty of prudence, the fact that the trustee has the power to make such investments does not relieve him of the fiduciary duty to exercise prudence. In dealing with common law duties, and in a situation in which there is no instrument, the duties are not modified.

C. Duties of Various Fiduciaries

Not every fiduciary relationship produces the same fiduciary duties. This can be easily seen when the relationship between a principal and his agent is compared to the formal fiduciary relationship between a trustee and a beneficiary. An examination of the common law fiduciary duties will demonstrate that the duties differ based upon the relationship. In dealings between husband and wife, it is clear under existing law that the fiduciary duties, if any, each owes to the other with respect to the management of each spouse's community property are severely limited.

D. Common Law Fiduciary Duties

Common law fiduciary duties are duties that have been created by the courts to apply to fiduciaries. These duties may apply to all types of fiduciaries (*e.g.*, executors, trustees, guardians, attorneys, custodians, agents, donees of powers of attorney, banks, partners, joint venturers, or corporate management) or may apply to specific fiduciaries such as trustees only.[2] The primary duties which apply broadly are discussed below and then analyzed later as to their application to the husband-wife relationship.

1. Prudence

The common law duty to exercise ordinary skill and prudence is usually stated as follows:

> In making investments of trust funds the trustee is under a duty to the beneficiary
>
> (a) ...to make such investments and only such investments as a prudent man would make of his own property having in view the preservation of the estate and the amount and regularity of the income to be derived;....[3]

Restatement (Second) of the Law of Trusts (1959), §174. *See also InterFirst Bank Dallas, N.A. v. Risser*, 739 S.W.2d 882, 888 (Tex. Civ. App. -- Texarkana 1987, no writ), citing *Tucker v. Dougherty Roofing Company*, 137 S.W.2d 884 (Tex. Civ. App. -- Dallas 1940, writ dism'd judgment cor.); Bogert & Bogert, *The Law of Trusts and Trustees* (2nd ed. 1985) § 541; Scott and Fratcher, *The Law of Trusts* (4th Ed. 1988).

2. Loyalty

Without a duty of loyalty there can be no fiduciary relationship. However, the duty of loyalty can clearly be modified, and applied in somewhat different forms to different relationships. The common law duty of loyalty is basically as follows:

> One of the most fundamental duties of the trustee is that he must display throughout the administration of the trust complete loyalty to the interests of the beneficiary, and must exclude all selfish interest and all consideration of the interests of third persons.

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[2] Much of this discussion is taken from an article prepared by Frank N. Ikard, Jr.

[3] The Texas Rule set out in Texas Trust Code §113.056 is stated slightly differently in that it also imposes a duty on the trustee to consider not only safety but also potential for appreciation:

> A trustee shall exercise the judgment and care under the circumstances then prevailing that persons of ordinary prudence, discretion and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income from as well as *the probable increase in value and th*e safety of their capital. (Emphasis supplied.)

Bogert, *supra,* § 543, Scott, *supra*, § 170; Restatement (Second) of Trusts, *supra,* § 170; Pomeroy, *Equity Jurisprudence*, 5th Ed. §955 -965; *Johnson v. Peckham,* 120 S.W.2d 786 (Tex. 1938); *Kinzbach Tool Company v. Corbett-Wallace*, 160 S.W.2d 509 (Tex.1942); *International Bankers Life Insurance Company v. Holloway,* 368 S.W.2d 657 (Tex. 1963); *Archer v. Griffith,* 390 S.W.2d 735 (Tex. 1964); *Stephens County Museum v. Swenson*, 517 S.W.2d 257 (Tex. 1974); *Texas Bank and Trust Company v. Moore,* 595 S.W.2d 502 (Tex. 1980); *Loewenstein v. Watts*, 119 S.W.2d 176 (Tex. Civ. App.--El Paso), aff'd. 134 Tex. 660, 137 S.W.2d 2 (1938); *Gaines v. First State Bank*, 28 S.W.2d 297, aff'd., 121 Tex. 559, 50 S.W.2d 774 (Tex. 1930); and *Albuquerque National Bank v. Citizens National Bank*, 212 F.2d 943 (5th Cir. 1954).

In applying this rule, the courts have held that the duty of loyalty can be breached in the absence of bad faith or intent to defraud. There can be a breach of the duty of loyalty even though the beneficiary was not damaged and even though the fiduciary acted in good faith. *Slay v. Burnett Trust,* 187 S.W.2d 377 (Tex. 1945).

A subset of the duty of loyalty is self-dealing. The violation of the common law duty against self-dealing is often analyzed in terms of constructive fraud. The constructive fraud doctrine provides that if a fiduciary takes any discretionary action as a fiduciary which directly or indirectly benefits the fiduciary (or the fiduciary's family or affiliates) then the transaction is presumed fraudulent. The burden of proof then shifts to the fiduciary to prove that the transaction is fair. In any transaction wherein a person benefitting from it stands in a fiduciary relationship to one or more of the other parties, the transaction, if challenged, is presumed by equity to be unfair and, therefore, a constructive fraud unless the fairness of the transaction is proven by the benefitting fiduciary. *Stephens County Museum, Inc. v. Swenson,* 517 S.W.2d 257, 260 (Tex. 1974). Unlike actual fraud, constructive fraud does not necessarily involve dishonesty of purpose or an intent to deceive and, therefore, proof of such is not required in order to invoke the doctrine. *Archer v. Griffith,* 390 S.W.2d 735, 740 (Tex. 1964). Thus, once a plaintiff establishes that the transaction which he wishes to avoid was executed while a fiduciary relationship existed between him and the defendant, the burden of presenting evidence and securing a finding that the transaction was fair to the plaintiff is put upon the defendant fiduciary who claims the validity of and benefits from the transaction. *Ginther v. Taub,* 570 S.W.2d 516, 525 (Tex. Civ. App.--Waco 1975, writ ref'd n.r.e.); *Gaynier v. Ginsberg,* 715 S.W.2d 749,754 (Tex. App.–Dallas 1986, writ ref'd n.r.e.). Evidence introduced by the defendant to meet this burden simply creates a question of fact. *Ginther,* 570 S.W.2d at 525. Absent any such proof, the presumption of unfairness and constructive fraud stands unrebutted, and the transaction is invalid as a matter of law. *Texas Bank and Trust v. A. E. Moore*, 595 S.W.2d 502 (Tex. 1980). Because the burden of proof in this cause of action is shifted to the defendant, it is distinguishable from other types of "constructive fraud" in which the entire burden rests on the party asserting it. *Miller v. Miller,* 700 S.W.2d 941 (Tex. App.–Dallas 1985, writ ref'd n.r.e.).

3. Disclosure

A fiduciary has the duty to keep the beneficiary fully informed, at least as to non-standard transactions. *See InterFirst Bank v. Risser*, *supra*.

VII. DUTIES AS COMMUNITY MANAGER

Texas law has long been clear that, during the marriage relationship, the managerial spouse has the absolute right to manage, control and *dispose of* his sole management community, subject only to the duty not to defraud the spouse. Even though she "owns" one-half of the property, the sole rights of the non-managerial spouse (other than the right not to be defrauded) are (i) to dispose of her one-half of her spouse's sole management community at death, (ii) to acquire ownership and management of her community interest in such asset at the death of the managerial spouse [subject to administration by the personal representative of the managerial spouse under Texas Probate Code Ann. §177(b)]; and (iii) to have the court divide such sole management community upon the dissolution of the marriage in a manner that is just and right. The 1967 changes which created the different classes of community management were not designed to restrict the control of the manager, but rather to spell out the property which was under the control and management of each spouse.

A. Duty of Support

As noted above, the spouses have a duty to support each other. The case law makes it clear that the support is to be first provided from the community property. If the community property is not sufficient, then the spouse is obligated to provide such support from his separate funds. Such separate funds are deemed to be a gift to the community, and are not subject to a right of reimbursement. *Norris v. Vaughn,* 260 S.W.2d 676 (Tex. 1953). *See also Henderson v. Henderson,* 425 S.W.2d 363 (Tex. Civ. App. — San Antonio 1968) and *Patt v. Patt*, 689 S.W.2d 505 (Tex. Civ. App. — Houston [1st Dist.] 1985)

B. Manager as Fiduciary

It is unfortunate that referring to the spouse having management rights as a "fiduciary," or even a "trustee," has become a common practice, without necessarily contemplating the effect of that characterization if taken at face value. Even scholars in this area fall into this trap, even though the statement is later qualified. For example, Professor Featherston comments:

> The spouse who is managing sole management community property can be compared to a trustee. The managing spouse has extensive powers of management and the duty not to defraud the non-managing spouse of that spouse's community interest in the sole management community.

Featherston and Douthitt, *Changing the Rules By Agreement: The New Era in Characterization, Management, and Liability of Marital Property,"* 49 Baylor Law Review 271, 279 (1997). In the footnote accompanying the text, the authors cite three cases for the above proposition, *all of which deal with fraud on the community; i.e.,* the disposition of sole management community by gift.

In another article in that same issue of Baylor Law Review, under the paragraph heading "The Fiduciary Duty That Arises with Special Community Property," the author comments:

> Although a spouse has the power to manage, control, and dispose of his or her special community property without his or her spouse's joinder, this power is not absolute. The managing spouse is the fiduciary of the other spouse in the management, control, and disposition of special community property. [FN. omitted.] "A trust relationship exists between husband and wife as to that community property controlled by each spouse." [Citing *Carnes v. Meador,* 533 S.W.2d 365, 370 (Tex. Civ. App. — Dallas 1975, writ ref'd.,) which case, also cited in the Featherston-Douthitt article, deals with a classic fraud on the community issue.] As a result of this relationship, the managing spouse owes a duty to the other spouse not to transfer his or her special community property in actual or constructive fraud of the other spouse's undivided one-half interest in that property.

Bradley L. Adams, Comment, *The Doctrine of Fraud on the Community,* 49 Baylor Law Review 445, 449 (1997). Again, a reading of only the first sentence (and the quote from *Carnes*) would lead one to believe that a fiduciary relationship exists which could encompass the entire panoply of fiduciary duties. These two quotations and a reading of court opinions show that the courts consistently assert that husband and wife are fiduciaries, but in **every** case the duties of the managerial spouse are limited to issues of fraud on the spouse by a gratuitous disposition of community property.

Professor Bogert, in his seminal work on trusts, recognizes that the nature of the community property relationship is not analogous to a trust:

> It would seem that the community property system involves a unique relationship created by statute, possibly resembling partnership or tenancy in common, but not modeled after any method of property holding developed by the courts of law or chancery under Anglo-American law, and *which cannot in any strict sense be said to be a form of express trusteehip.* (Emphasis added.)

Bogert & Bogert, *The Law of Trusts and Trustees* (2nd ed. 1985) §26.

C. Fiduciary Duties of Community Manager

Distilling current law down to its essence, the courts seem very clear, and the decisions totally consistent,

that the sole fiduciary duty which the manager of the community owes to the other spouse is not to commit fraud with respect to that other spouse's interest in the community. Even to that limited extent, calling such a fiduciary duty does not necessarily make it so.

1. Prudence

Does the fiduciary duty of prudence apply to the community manager? Because of the very broad statutory powers of management, and the case law which give him absolute power of management over his sole management community, it is highly doubtful that the duty of prudence would apply. While for his own good he should exercise some discretion, he does not have to act prudently as that term is used in fiduciary law. Using sole management community property to purchase a Ferrari to satisfy the middle-aged crazies (or some other urge) may not be prudent, but it is clearly permissible.

2. Loyalty

The common law fiduciary duty of loyalty has been modified by long standing and well settled Texas case law as it applies to sole management community property. The only duty of loyalty that the manager owes to his wife is the duty not to deal fraudulently with the property. The fraud referred to here is constructive fraud, and, as in any fiduciary setting, the burden of proof is on the community manager to prove that the transaction was fair. *See* Bradley L. Adams, *supra* at 462. The elements of fairness are set forth in the cases, and include balancing what was given away versus the value of the entire community estate, establishing the relationship between the husband and the recipient of the gift (*i.e.,* natural object of the donor's bounty or a stranger to the marriage and family), and what benefits did the wife receive from the community. *See, Horlock v. Horlock,* 533 S.W.2d 52 (Tex. Civ. App. — Houston [14th Dist] 1975) and *Krueger v. Williams,* 359 S.W.2d 48 (Tex. 1962). See the discussion in Article VI, below.

In fact, **the ability to make a gift under any circumstances** is inconsistent with the view that the manager is a fiduciary comparable to a trustee. A trustee cannot, under any circumstances gratuitously transfer trust assets, especially in satisfaction of his own ends and desires to the detriment of the beneficiary.

3. Disclosure

There is no requirement under Texas law that the managing spouse keep the other spouse informed as to his dealings with his sole management community. Because of her ownership interest in the property, good judgment would dictate that the spouse be kept informed. However, in *Horlock,* the husband testified that he did not tell his wife about the gift because he knew she would object, and the court found no problem with such failure.

D. The California Approach

California has approached the issue of fiduciary relationships between spouses by enacting statutes dealing with that issue. It is worth noting that the California statutes do **not** impose a fiduciary duty on either of the spouses when such spouse is managing his separate property. Rather, the fiduciary duties are limited to the spouses when dealing with the community property or with each other. This is the same approach which Texas law has taken *vis-a-vis* fiduciary duties.

1. Management and Control

Section 1100 of the California Family Code deals with management of personal community property. Subdivision (a) provides that either spouse has the same management rights over the community personal property as the spouse has of the separate estate of that spouse, other than in the operation or management of a business. Thus, the management regime is vastly different from that of Texas in that both spouses have equal and coexisting control over the entire community estate. Subdivision (b) prohibits gifts of community without the written consent of the other spouse.

2. Fiduciary Duties

Section 1100(e) defines the fiduciary duties of the spouses:

(e) Each spouse shall act with respect to the other spouse in the management and control of the

> community assets and liabilities in accordance with the general rules covering fiduciary relationships which control the actions of persons having relationships of personal confidence as specified in Section 721....This duty includes the obligation to make full disclosure to the other spouse of all material facts and information regarding the existence, characterization and valuation of all assets in which the community has or may have an interest and debts for which the community is or may be liable, and to provide equal access to all information, records, and books that pertain to the value and character of those assets and debts, upon request.

Prior California law required that the manager act in "good faith." Although the statute was not supposed to change the substantive law, the case law indicates that the standards of conduct were raised. *In re Marriage of Reuling,* (App. 1 Dist 1994) 28 Cal. Rptr.2d 726. Section 721 of the California Family Code first gives the spouses the right to deal with each other in a manner "which either might if unmarried." Subdivision (a). Subdivision (b) then goes on to provide:

> [I]n transactions between themselves, a husband and wife are subject to the general fiduciary relationships which control the actions of persons occupying confidential relations with each other. This confidential relationship imposes a duty of the highest good faith and fair dealing on each spouse, and neither shall take any unfair advantage of the other. This confidential relationship is a fiduciary relationship subject to the same rights and duties of other nonmarital business partners....

The section then goes on to provide that each spouse will give the other access to all books, keep the other informed, and account to the other.

When read together, Cal. Family Code §§721 and 1100 make it clear that the spouses are in a fiduciary relationship *when they deal with each other.* But, notice that the duties do not extend to the way in which spouses deal with their separate property or with third parties. The fiduciary duties appear to be limited to full disclosure and access to information.

VIII. TEXAS LAW AND SPOUSAL FIDUCIARY DUTIES

A. Non-Managing Spouse's Rights

Just as the Texas Constitution defines separate property specifically, thereby making everything else community property by implication, so the rights of the non-managerial spouse are what is left after the rights of the managerial spouse are defined.

1. Rights of Managerial Spouse

The breadth of the rights of the managerial spouse is clearly spelled out in *Brown v. Brown*, 282 S.W.2d 90 (Tex. Civ. App. — Waco 1955):

> In construing and applying this statutory provision [Art. 4619 V.A.T.S which designated the husband as the sole community manager], our courts have held that the right of the husband to dispose of community property is an absolute right so long as it is not exercised for the purpose of defrauding the wife. (Citations omitted.) In *Moody v. Smoot, supra* (78 Tex. 119, 14 S.W. 286), the Supreme Court said with reference to the husband's power over the community property of himself and his wife: "His control of it during her life is absolute. Barring any disposition made with intent to defraud her, he may sell, barter, or give it away."

Id., at 92. A case construing the present statutory scheme framed the rule :

> While there may be a fraud on one spouse's community interest where the special community property of the other spouse is involved, the fact that the gifts at issue consist of special community property is important in considering the rights of disposition which accrue to that spouse. It is not necessary that one spouse approve or agree with the dispositions made by the other spouse of that spouse's special community property.

Tabassi v. NBC Bank — San Antonio, 737 S.W.2d 612 (Tex. Civ. App. — Austin 1987), 617.

2. The Fifth Circuit Analysis

The Fifth Circuit engaged in an exhaustive and scholarly analysis of Texas community property law in the federal estate tax case of *Wyly v. Commissioner,* 610 F.2d 1282 (5th Cir. — 1980). This case actually involved three different cases with similar fact patterns. The real issue in each case was whether Texas community property law "by unavoidable operation" caused the husband to retain an interest in the income from a gift to his spouse. In *Wyly*, husband established an irrevocable trust which was to pay the income to his wife for her life, and at her death would terminate and be divided and held in trust for grandchildren. The Commissioner sought to include the trust in Mr. Wyly's estate under the authority of Internal Revenue Code §2036(a) since the income paid to the wife would be community property, albeit her special community property.[4] The Court rejected the government's contention, finding that the ownership interest of the non-managerial spouse was so limited that it did not amount to a retained right to receive the income. So that there could be no misunderstanding, the appellate court stated that Texas law severely limits the duties owed by the managerial spouse to the non-managerial spouse.

> Texas courts have held that, in the absence of actual or constructive fraud on the interest of the other spouse, it [the right to manage and dispose of sole management community] is an absolute right, *Moody v. Smoot,* 78 Tex. 119, 14 S.W. 285 (1890), and that a spouse is able, in the absence of fraud, to deal with sole management community as he or she might with respect to his or her own separate property, *free from any participation, consent or interference by the other spouse.* (Citation omitted and emphasis added.)
>
> The functional interest of the non-managing spouse in this sort of property comes down by the general consensus (*sic*) of all parties, to two situations: (1) a spouse's ability to complain of fraud on his or her interest, and (2) his or her ability to complain that the other spouse used such income to improve a separate estate and to petition a court for an accounting thereof. (FN. omitted.)
>
> With regard to the first situation, a non-managing spouse has been found to have a cause of action for fraud only where the managing spouse made gifts or transfers of community property which were held to be "excessive or capricious."

Id., at 1289.

> Thus, existing Texas law in the area teaches that the only relevant consequence of a spouse's ownership of a community property interest in income from the other spouse's separate property is an *inchoate* standing to complain that the other spouse made an excessive or capricious gift to a third party, or to demand an accounting at the dissolution of the marriage or partition, alleging the income was used for to improve the other spouse's separate property. (emphasis added.)

Id., at 1290. The reference to use of the funds for the improvement of separate property has to do only with the expenditure of such funds for the benefit of the separate property which gives rise to a right of reimbursement.

B. Fiduciary Duties with Respect to Enhancement of Separate vs. Community Property

Not surprisingly, there is little case law which analyzes the duties of the manager of community property with respect to management and investment of his separate property. What little law there is, however, is

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[4] "(a) GENERAL RULE. — The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death —

(1) the possession and enjoyment of, or the right to the income from, the property....

clearly in line with the existing case law providing that the only duty owed by the managerial spouse is not to dispose of the special community property in fraud of the spouse's rights, and that no duty to enhance the community exists. Further, there is no duty to forfeit an investment opportunity available to the managerial spouse's separate estate in favor of investing for the community estate.

1. *Holloway v. Holloway*

In the only Texas case in which the issue of enhancing the separate estate at the expense of the community estate was squarely confronted, the court rejected the concept of any fiduciary duty in the absence of an intent to defraud. *Holloway v. Holloway,* 671 S.W.2d 51 (Tex. Civ. App. — Dallas [5th Dist.] 1983 writ dismissed). In that case, a husband had taken what was found to be separate funds and formed two corporations. One corporation grew from an initial $1,000 capitalization to a value of $30,000,000, and the other grew from an initial capitalization of $3,000 to a value of $60,000,000. The second corporation was capitalized with the proceeds of a loan to "Patrick S. Holloway, Separate Property," and deposited into an account denominated "Separate Property." Mr. Holloway testified that the collateral for the loan was his separate property. The jury found the investment to have been made from separate property and the appellate court found that there was sufficient evidence for the jury to "infer" an agreement between husband and the bank that the loan was to be husband's separate debt, and that the determination as to the character was controlled by the agreement between the debtor and the bank.

On the dissolution of the marriage, the wife sought to impose a constructive trust on the stock in the corporation and argued that the husband breached his fiduciary duty to her as the non-managerial spouse.

> Another "finding of fact" attacked on this appeal is one to the effect that Pat Holloway, as manager of the community estate, unjustly enriched his separate estate by diverting community funds into separate corporations, and, therefore, a constructive trust should be imposed in Robbie's favor on a portion of the stock in those corporations....Robbie now contends, however, that a constructive trust was properly imposed because in the incorporation and management of both companies Pat breached a fiduciary duty owed to the community estate. She argues that Pat used both corporations so as to defraud his wife of her community interest in that he diverted a community opportunity by using separate funds for this purpose when there were adequate funds in the community estate.
>
> ...In engaging in a new and speculative venture and borrowing funds for that purpose, a married entrepreneur may well consider whether the risk is one that should properly be undertaken by himself alone without jeopardizing the assets of the community estate. If the venture turns out to be successful, as it did here, he cannot be held guilty of a breach of fiduciary duty in the absence of evidence of an intent to defraud.

Id., at 59-60.

Holloway also dealt with the related issue of the so-called "community efforts doctrine." The wife argued that a portion of the stock was community property because of the effort invested by the husband in causing the companies to grow. The court applied the rationale in *Vallone v. Vallone,* 644 S.W.2d 455 (Tex. 1982) and *Jensen v. Jensen,* 665 S.W.2d 107 (Tex. 1983), holding that the character of the property at its inception controlled the character, and remanded the case for trial as to whether the compensation received by the husband from the corporations was adequate. To the extent that it was not, a right of reimbursement would arise in favor of the community estate, but the stock itself would retain its separate character.

Thus, in the only case dealing directly with the issue, the court refused to blaze new trails by creating a duty which has no basis whatsoever in Texas law.

2. The Supreme Court Lays It Out

In *Schlueter v. Schlueter*, 975 S.W.2d 584 (Tex. 1998), the wife filed for divorce and also sued for damages to the community property estate for fraud, breach of fiduciary duty, and conspiracy. Husband had transferred assets to his father for less than full value and had apparently tried to hide assets by transferring

them to his father. The essence of the wife's claim was fraud on the community by transferring community property for less than full consideration. The purpose of this separate cause of action, rather than seeking reimbursement to the community estate, was to get punitive damages for the alleged fraud and breach of fiduciary duty. The Supreme Court summed up Texas law in its introduction:

> Because a wronged spouse has an adequate remedy for fraud on the community through the "just and right" property division upon divorce, we hold that there is no independent tort cause of action between spouses for damages to the community estate.

Mrs. Schlueter argued that an independent tort was necessary because the husband's action were intentional and exemplary damages were necessary in those circumstances. The Court replied:

> However, heightened culpability does not change the essential character of the wrong: a deprivation of community assets as opposed to a tort committed against a person or his or her separate property.

The court sanctioned the rule that a money judgment may be awarded for fraud on the community, but only to recoup the community assets lost as a breach of trust. The reference, once again, is not to anything so vague as a lost community investment opportunity, but rather to an actual depletion of the community by transfer. It would seem clear from this opinion that a district court can take the actions of the propertied spouse into consideration in dividing the community property. It would also seem clear that the Supreme Court is not likely to create a whole new cause of action based, not upon an actual dissipation of the community, but rather upon an alleged failure to enhance the community at the expense of the manager's separate estate; or, in the case of disclaimers or failure to exercise withdrawal powers, for making decisions (probably of independent significance) concerning his separate property that fail to enhance the community. (See discussion below.)

3. Or Did They?

Chief Justice Phillips and Justice Hecht dissented in *Schlueter*. While *Schlueter* was under consideration, an application for writ of error was filed in *Vickery v. Vickery*[5]. In fact, the dissent in *Schlueter* even made reference to *Vickery,* implying, at least, that the issues were the same. However, the Court refused to grant error, causing Justice Hecht (but not Chief Justice Phillips) to write and publish a dissent. 999 S.W.2d 342 (Tex.1999).

The facts in *Vickery* were egregious to say the least. Glenn Vickery, a personal injury attorney with a community estate of approximately $14.6 Million. He told his wife, Helen, that they needed to get divorced because one his former clients was suing him for malpractice and that the divorce was necessary to protect their property. Helen did not want the divorce, so Glenn called Diane Richards, a law school classmate, to file a divorce for Helen, which Ms. Richards did without ever talking to Helen or informing her that the divorce had been filed. Another lawyer in Ms. Richards' office prepared an answer and counterclaim for Glenn which he signed on a *pro se* basis. Helen was unaware of this also. Glenn persuaded Helen to sign an agreed decree awarding her $1.1 Million as her community share. He also failed to inform her that the malpractice suit had settled within policy limits a month earlier.

Thereafter, Glenn realized that a ranch which was his separate property had not been described by metes and bounds in the divorce decree, and got Helen to agree to a judgment *nunc pro tunc* describing the ranch and making clear that it was his separate property. The next day, Glenn hired a lawyer to evict Helen and their daughter, and within six weeks he had married one of Helen's former best friends. In what can only be described as a profound understatement, Justice Hecht noted: "Realizing at last the depth of her former husband's deception,..." *Id.,* at 343.

Justice Hecht felt that this case was controlled by *Schlueter*, and that had the Court granted writ, it would

[5]The Harris County First District Court of Appeals opinion was unpublished, but Justice Hecht attached it to his dissenting opinion.

have been forced to reverse and remand. Justice Hecht felt that the *Schlueter* decision had stated that fraud on the community was not a separate cause of action that would allow the actual and punitive damages that Helen had been awarded, and that the Court was required to apply its own rules in subsequent cases.

One of Helen's appellate lawyers argues that *Vickery* can be distinguished in that it did not involve a disposition of community property in fraud of Helen's rights, but that it involved rather a fraud on Helen with respect to the property wich was to be set aside in a divorce. Brown, *Marital Fraud: The Tort Survives with an Appellate Twist*, Vol. 63, No. 7 Texas Bar Journal 630. Obviously, a majority of the Court agreed that the essential nature of the wrong was not fraud on the community.

Justice Hecht's opinion did not deal with fiduciary duty between spouses, and the Court of Appeals focused on the fact that Glenn was a lawyer and breached his fiduciary duty in that capacity. The simpler, and more straightforward analysis is that spouses clearly owe a fiduciary duty to each other when dealing with each other This is especially true when one spouse fails to disclose relevant information to the other in dealing with community property *inter se.* Thus, there is clearly a breach of fiduciary duty by Glenn *vis-a-vis* Helen.

4. Application in Probate

A recent opinion of the Fort Worth Court of Appeals deals with fraud on the community after the death of the allegedly wronged spouse. *Harper v. Harper*, 8 S.W.3d 782 (Tex. App.–Fort Worth 1999). In that case, the husband purchased land with community funds and he also made improvements to the land. Title was taken in the name of the wife's former caretaker (whom he married one month after his wife's death), and the property was sold after the wife's death. Husband repaid the community estate one-half of the sales proceeds plus interest. The executor of the wife's estate (their son) sued for fraud on the community and unjust enrichment. A jury found that husband had committed a fraud on the community and assessed actual and punitive damages for that breach of fiduciary duty. They also found that the former caretaker had been unjustly enriched.

The Court upheld the unjust enrichment verdict on largely procedural grounds, but reversed the damages for breach of fiduciary duty. Relying on *Schlueter,* the Court held that there was no independent cause of action for fraud on the community and that such an action could **only** be maintained in connection with a divorce, and there only in dealing with the just and right division of the property. Thus, since the wife died, there was no cause of action.

While in *Harper* the aggrieved spouse died first, a fair reading of this opinion would also deny a cause of action in the reverse situation; *i.e.*, the spouse accused of committing the fraud dies first. After all, the theory behind the case is not that the cause of action died with the wife, but that the cause of action exists only in a divorce context. The logical conclusion is thus that it does not matter which spouse dies first if the Fort Worth court has accurately interpreted *Schlueter.*

IX. THE RAMIFICATIONS

If there is a fiduciary duty between spouses, what are the practical and legal effects of such duty and how might they be dealt with?

A. Marital Property Agreements

Suppose that persons about to marry or spouses are concerned about the fiduciary duty issue. Can it be dealt within marital property agreements? As a general proposition, the release of a fiduciary is not valid unless based upon full information in the hands of the releasing beneficiary. Since there is no way of knowing what investments the husband might make, it would seem impossible for the wife to release him from future acts which might constitute a breach of fiduciary duty. Additionally, some court might construe an attempt to do so as the creation of a contractual fiduciary duty. (The author does not believe that the creation of such a relationship is possible, but has seen enough court decisions to worry about it.)

B. Investments

If such fiduciary duty exists, how is the managerial spouse to decide whether to invest community or separate property in any particular investment? If he decides that the investment is too risky for the

community, and it turns out to be a home run, then upon dissolution of the marriage, it is a certainty that the wife will contend that he should have invested community property. If, on the other hand, he invested community property and the investment went south, then it is fairly easy to guess that the wife will claim that he acted imprudently. It is truly a case of damned if you do and damned if you do not. The effect is to make the husband a guarantor of his investments, which is a higher standard than that imposed upon a trustee.

C. Life Style

Suppose that the managerial spouse expends the entire community in lavish living while investing his separate property. Surely, there could be no basis for challenging the right of the managing spouse to expend the amount he desires for the support of the community.

D. Disclaimers

It has been argued that the fiduciary duty of the spouse is to enhance the community estate. It has been suggested by some commentators that a disclaimer by the managerial spouse breaches a duty to the non-managerial spouse. Even though the property would be separate property in the absence of a disclaimer, what the disclaimant has done, so the argument goes, is to deprive the community of the potential income from that property. Not only is this a real stretch of existing community property law, Texas Probate Code §37A makes it clear that a disclaimer is not a transfer. The disclaimer relates back to the moment of death, even to the extent that the disclaimed property is not subject to claims of creditors. *Dyer v. Eckols,* 808 S.W.2d 531 (Tex. Civ. App. – Houston [14th Dist.] 1991, writ dismissed). How can the managerial spouse have deprived the community of income from an asset when he did not effectuate a transfer of that asset under the law?

E. Withdrawal Powers

As a general rule, gifts to a trust are gifts of future interests and are thus not covered by the $10,000 annual gift tax exclusion. In many instances, particularly in life insurance trusts, the trust beneficiary is given the power to withdraw the contribution to the trust up to the annual exclusion amount of $10,000. In most instances, the beneficiary does not exercise his right to withdraw because that would impair the future benefits he will receive when the proceeds of the life insurance policy are received by the trust. (And it might cause the donor to discontinue future gifting.) The proposition has been advanced that the failure to make such withdrawal deprives the community estate of income from that property. Surely, the decision not to withdraw was an act of independent significance and any limitation on the managerial spouse's right not to withdraw would be a restraint on his ability to alienate his property, even though for tax purposes, the lapse of a power to withdraw does not result in a transfer. In fact, Texas Trust Code §112.035(e), provides that the lapse of a power does not constitute a transfer to a spendthrift trust.

X. CONCLUSION

It should first be conceded that in most situations, investment decisions, life style expenditures, disclaimers, failures to exercise withdrawal rights and other decisions are not usually made for the purpose of diminishing the community estate. (Obviously there are exceptions to this rule.) Thus, we are dealing in an area in which the managerial spouse suddenly finds himself being accused of something he had no intention of doing, and never even conceived of doing. Thus, the whole concept of breach of fiduciary duty between spouses is clearly and firmly grounded in that most venerated of legal principles — 20-20 hindsight. There is no basis whatsoever in existing Texas jurisprudence for the existence of such a duty. On the contrary, such "duty" has been affirmatively found not to exist.

The managerial rights between the spouses are creatures of statute. Those statutes give the managerial spouse an absolute right of control and disposition, subject only to the judicially created exception of fraud on the community. This structure of rights cannot form the basis for fiduciary duties.

The solution however, should not be to create a whole new public policy for the state of Texas and to impose judicially a duty unknown to Texas law and inconsistent with the entire concept of marriage. When the parties to the marriage must spend an extensive amount of time and energy worrying about whether each is breaching a undefined fiduciary duty, then it cannot help but impair the emotional relationship necessary

to nurture the marriage. Establishment of such a duty is truly, if you will pardon the cliche, the beginning of a journey down a very slippery slope.

Lastly, if the public policy of the state is to be changed, the legislature and not the courts should make such change. The creation of a whole new concept of liability between the spouses is such a basic change to marital property law that, if created at all, should be done by the legislative branch.