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HIGHLIGHTS

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Tracing Interests in Property

Trial Court May Consider and Credit Reasonable, Well-supported, and Nonspeculative Tracing that Departs from Common Tracing Methods

*By Carol Rothstein, Esq.**

In *In re Marriage of Ciprari* (Nos. B272039, B278187; Ct. App., 2d Dist., Div. 1. 2/6/19) 32 Cal. App. 5th 83, __ Cal. Rptr. 3d __, 2019 Cal. App. LEXIS 104, the Second District Court of Appeal held that a trial court was free to consider and credit reasonable, well supported, non-speculative expert testimony when determining whether the proponent has successfully traced an asset to a separate source. Although previous cases and treatises have discussed only two methods of tracing—direct tracing and exhaustion tracing—the appeals court explained that these sources do not foreclose the use of other methods, including the somewhat novel method used in this case.

In the opinion by Currey, J. (Rothschild, P. J., Bendix, J., concurring), the appeals court affirmed the trial court's findings that the husband, who managed the party's finances, did not violate his fiduciary duty by using his separate funds to purchase commonly available securities instead of first offering them to the community, nor did he violate his fiduciary duty by contributing community funds to the children's 529 accounts and establishing an insurance trust for the children's benefits as part of the couple's estate planning. However, it reversed a spousal support award and the court's denial of the wife's request for attorney fees, because the trial court failed to consider the applicable statutory factors.

Tracing of Separate Property. Joe and DeeDee married in 1995, separated in 2010, and a final judgment of dissolution was entered in 2016.

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Cross-references are made in this publication to CALIFORNIA FAMILY LAW PRACTICE AND PROCEDURE, 2nd ed. (7 vols.), CALIFORNIA FAMILY LAW LITIGATION GUIDE (5 vols.), and CALIFORNIA JUVENILE COURTS: PRACTICE AND PROCEDURE (1 vol.) Published by Matthew Bender & Co., Inc.

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Joe entered the marriage with $2,053,000 in separate property, $874,000 of which he gifted to the community and the remainder of which was held in a brokerage account. Throughout the marriage, Joe deposited portions of his salary, which was community property, into the brokerage account and other commingled investment accounts. By the end of 2014, there was $6.9 million in the commingled accounts. After sale of the family residence, Joe left the marriage with total assets of approximately $10.6 million, and DeeDee received approximately $5.2 million.

The appeals court explained that there is a basic presumption that all property acquired during marriage is community property [Fam. Code § 760], with the exception of gifts and inheritances, which are separate property [Fam. Code §§ 770(a), 771]. Profits from separate property are likewise separate property, no matter when they are earned [Fam. Code §§ 770(a), 771]. The presumption that property acquired during marriage other than by gift or inheritance is community property can be rebutted by tracing the property to a separate property source. Commingling separate and community property does not alter the character of the respective property interests, if it can be traced to separate and community sources. If the sources cannot be traced and identified, the commingled funds will be deemed community property, by virtue of the community property presumption.

Joe's forensic accountant conducted a tracing in which he analyzed account entries in 23 accounts over almost 20 years. For each account, he determined the character of every deposit, treating those deposits that he couldn't characterize as community property. Purchases of securities were treated as community property if there was sufficient community property cash in the account to make the purchase. If the community property cash in the account was not enough to purchase the securities, he characterized the investment as part community and part separate property, in proportion to the amount of each used to purchase the investment. The community was given the benefit of its investments, including interest, dividends, and sale proceeds.

Cash withdrawals were deposited in the couple's community bank accounts, and were treated as community property in the tracing. There was no evidence that the proceeds were used for any purpose other than family living expenses or community investments. Joe's accountant concluded that, at the end of 2014, the combined balance in the investment accounts was approximately $6.9 million, of which approximately $3.8 million was Joe's separate property and $3.1 million was community property. The trial court adopted the findings in the tracing.

Tracing Method Used by Joe's Expert Was Not Invalid. DeeDee argued that the tracing was invalid because Joe's accountant did not use a tracing method permitted by California law; Joe did not prove his intent to use separate property funds to purchase any particular asset; and Joe's accountant assumed assets were purchased with separate property funds whenever no community funds were available in the account in question, without considering whether community funds were available in a different account.

The appeals court explained that California case law has recognized two tracing methods: direct tracing and exhaustion tracing. Direct tracing can be used to demonstrate a spouse's separate property was used to purchase an asset, if there is documentary proof that there were sufficient separate property funds in the account at the time of purchase and proof that the spouse who made the purchase intended to use separate funds. Exhaustion tracing traces an expenditure to separate property funds by showing that all community funds were exhausted at the time the payment or purchase was made. Exhaustion tracing presumes that family expenses are paid with community funds, to the extent such funds are available.

Although only two methods of tracing have been recognized, the court found that there was no reason to prohibit other tracing methods. The cases and treatises that state that tracing may be done by these two methods [*see, e.g.,* In re Marriage of Stoll (1998) 63 Cal. App. 4th 837, 841] do not say that other methods are prohibited. The appeals court stated that trial courts are free to consider reasonable, non-speculative and well-supported expert testimony to determine whether the party tracing assets has met his or her burden of proof. Moreover, the court wrote, Joe's method of tracing separate property to a particular commingled account was not unprecedented; the forensic accountant in *In re Marriage of Cochran* [(2001) 87 Cal. App. 4th 1050] also traced separate property by characterizing the activity within a particular commingled account.

DeeDee argued that Joe was required to demonstrate that no community funds were available in any account before a purchase could be characterized as separate property, thereby confusing Joe's tracing methodology with exhaustion tracing. The appeals court stated that the availability of funds in a different account was irrelevant to the tracing because it would not have changed the characterization of funds inside any given account. While community living expenses are presumed to have been paid with community funds if such funds are available anywhere, the appeals court stated, there is no reason to presume an investment made from a commingled account is a community asset if all of the community funds in the account were exhausted before the investment was made.

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The appeals court concluded that substantial evidence supported the trial court's finding that Joe carried his burden of proof with respect to marital tracing and findings concerning characterization of remaining assets in marital estate.

DeeDee also contended that characterizing an investment as Joe's separate property while community funds were available in other accounts was an appropriation of a partnership opportunity and a mismanagement of community assets, in violation of Joe's fiduciary duties of loyalty and care. However, DeeDee did not point to any evidence that Joe and the community were competing for unique investment opportunities, and the investment accounts primarily contained publicly traded stocks and bonds. DeeDee also did not cite evidence that would support a conclusion that Joe had mismanaged community funds and had, in fact, conceded that Joe's investments were quite successful.

Joe Did Not Breach Fiduciary Duty by Funding Children's 529 Accounts and by Establishing a Life Insurance Trust Naming Children as Sole Beneficiaries. DeeDee asserted that Joe breached his fiduciary duties under Family Code section 1100(b) by (1) depositing $160,000 into the children's 529 accounts and (2) using $245,000 in community funds to pay the premiums on whole life insurance to fund a life insurance trust for the sole benefit of the parties' children, both without first obtaining DeeDee's written consent.

Family Code section 1100(b) provides, in relevant part: "A spouse may not make a gift of community personal property, or dispose of community personal property for less than fair and reasonable value, without the written consent of the other spouse. This subdivision does not apply to gifts mutually given by both spouses to third parties. . . ." Joe testified that he and DeeDee discussed estate planning in 2009 and that DeeDee was fine with the 529 accounts and the life insurance policy. DeeDee conceded at trial that she agreed with the plan to set up 529 accounts and thought they were a good idea, but claimed that she was unaware of the contributions and the life insurance policy until after the fact.

The trial court rejected DeeDee's claims and found no breach of fiduciary duty. The appeals court concluded that substantial evidence supported the trial court's implied conclusion that Joe was merely executing a mutually agreed-upon estate plan of gifting to the children.

Modification of Temporary Child and Spousal Support. In December 2013, DeeDee filed a request for order to modify temporary child and spousal support. The trial court ruled on the motion in March 2016 and retrospectively modified spousal and child support for 2014 and 2015.

The trial court relied on the parties' 2013 tax returns to determine their income for 2014. DeeDee contended that this was an abuse of discretion, because the 2014 tax returns, which were in evidence at the time the modifications were made, would have been a more reliable indicator of actual 2014 income. The appeals court agreed. A court must rely on past income figures to predict future income when it makes its initial child and spousal support awards, the court stated. However, the trial court in this case was retroactively modifying support for 2014, and the parties' 2014 tax returns provided reliable income data for that year. The appeals court remanded for the trial court to recalculate temporary child and spousal support for 2014, considering the parties' 2014 tax returns or other "authoritative" evidence of 2014 income, as well as any other relevant factors.

Court Failed to Consider Relevant Factors in Determining Permanent Spousal Support. The trial court awarded DeeDee $5,000 per month in permanent spousal support. DeeDee argued that this amount was too low, given the marital standard of living and Joe's ability to pay more.

The trial court has the authority to order spousal support in an amount and for a duration that the court determines is just and reasonable, based on its consideration of the factors listed in Family Code section 4320. These factors include the supporting spouse's ability to pay; the parties' needs, based on the marital standard of living; and the obligations and assets of each spouse. Although the court has broad discretion in weighing the statutory factors, it does not have discretion to ignore an applicable statutory factor.

Here, the trial court found that after the division of assets, neither party would have any debt and both parties would have "a significant asset base." It found that Joe had $47,040 in taxable monthly income and that DeeDee's taxable monthly income was $20,790. The court found that the parties had lived an upper-class lifestyle with no real spending curbs, but found that the $36,700 in monthly expenses listed by DeeDee on her Income and Expense Declaration (Form FL-150) was inflated and that the form was therefore unreliable. Finally, it found that Joe had the unquestionable ability to pay support.

On appeal, DeeDee contended that the trial court failed to make a finding concerning what her needs actually were. The appeals court agreed, explaining that the marital standard of living is a description of the parties' lifestyle at the time of separation and is not the "absolute measure of reasonable need" [*quoting* In re Marriage of Nelson, (2006) 139 Cal. App. 4th 1546, 1560]. After weighing the relevant statutory factors, the trial court may fix spousal support at an amount greater than, equal to, or lower than the marital standard of living, to achieve a just and reasonable result.

DeeDee contended that the $5,000 permanent support award was disproportionately low when compared to Joe's ability to pay, considered in light of the parties' upper-class marital standard of living. The trial court did not explain why it was just and reasonable to award DeeDee $5,000 a month, when Joe's monthly income was $47,000 and the amount awarded, added to DeeDee's monthly income, would not support a standard of living equivalent to the marital standard of living. Because the trial court did not relate the support award to either DeeDee's FL-150, which it chose to disregard, or to the marital standard of living, the appeals court was "left to guess what evidence, if any, supported the trial court's determination that the support award is sufficient to meet DeeDee's 'needs.'" The appeals court reversed the permanent spousal support award and remanded for recalculation and clearer findings.

Court Abused Discretion When It Denied DeeDee's Request for Additional Attorneys' and Accountants' Fees. DeeDee contended that the trial court erred in denying her post-judgment motion for additional professional fees. At the time, DeeDee had incurred slightly more than $1 million in fees and Joe incurred roughly $1.2 million in fees, half of which was spent on his accountant's tracing analysis. Although the trial court found that Joe was in a better position to pay fees than DeeDee, the court denied DeeDee's request, in part because she had a significant asset base from which to pay fees.

DeeDee's ability to pays her own fees was not a bar to a need-based fee award, the appeals court wrote. The relevant inquiry was whether there was a disparity in access to funds to retain counsel and whether one part had the ability to pay for both parties' legal representation [Fam. Code § 2030(a)(2)]. If the findings demonstrate a disparity in access and ability to pay, an order awarding attorney's fees and costs is mandatory [Fam. Code § 2030(a)(2)]. In this case, the trial court impliedly found a disparity in access to funds for counsel and that Joe was able to pay for both parties' legal representation, making an award of fees to DeeDee mandatory.

However, the appeals court stated, a trial court is required to consider the reasonableness of the fees incurred and may deny a request for fees that it determines were not reasonably necessary. Here, the trial court found that the case had been overlitigated and the amount of fees sought by DeeDee was unreasonable. While the court found that the $500,000 Joe paid his accountant was reasonable because it enabled him to recoup his separate property, it found that DeeDee's accounting fees were not reasonably necessary because her forensic accountants relied on Joe's accountant's work. What the trial court overlooked, wrote the appeals court, was that if Joe had not "hopelessly commingled" separate and community property, much of the litigation cost could have been avoided. DeeDee could not be denied mandatory attorney fees for requiring Joe to trace his separate property and for incurring professional fees to review and litigate the issue. The appeals court expressed its concern that the trial court had labeled all of DeeDee's fees as unreasonable, and reversed and remanded for the court to conduct "[a] much more nuanced and granular inquiry."

Commentary

Dawn Gray

This is one of those cases that seems to involve every issue in the dissolution playbook, including family law appellate procedure. Of particular interest to me is its discussion of family law tracing, because

The bottom line is that this well-articulated case is an ideal read for any attorney and expert who may be involved in a complex tracing.

Commentary

Stacy D. Phillips and Kevin B. Martin

The Court of Appeal's opinion in *In re Marriage of Ciprari* is a must-read for all family law practitioners because of the large number of family law issues it touches upon. This commentary will focus on the Court of Appeal's holdings with respect to (i) separate property tracing and commingled accounts, and (ii) the application of Family Code Section 4320 factors and the setting of permanent support.

Tracing of Commingled Accounts, In *Ciprari,* one of the central issues on appeal was whether Husband's separate property tracing of the parties' commingled brokerage accounts was sufficient to support the trial's court finding that $3,791,653 of the $6.9 million in the commingled brokerage accounts was husband's separate property. On appeal, Wife did not challenge any of the underlying facts surrounding Husband's separate property tracing and instead argued that the tracing was insufficient because it was not predicated upon either a direct tracing or an exhaustion tracing. According to wife, these two methods of tracing are the ONLY property tracing methods approved under California law.

While direct tracing and exhaustion tracing are the two most common methods for property tracing, the Court of Appeal pointed out that California law does not preclude the trier of fact from considering other alternative tracing methods. Indeed, the Court of Appeal clearly stated that trial courts must not be "straightjacketed" by existing methods of tracing and must have the freedom to consider any credible evidence and evaluate alternative tracing methods to determine whether the proponent of the tracing has met their burden of proof. Driving this point home further, the Court of Appeal held that trial courts are free to consider and credit reasonable, well supported, non-speculative expert testimony, when determining whether the proponent has successfully traced an asset to a separate source. Here, while Husband's separate property tracing did not fit neatly into either a direct or exhaustion method of tracing, the Court of Appeal found that Husband's tracing could be relied upon as it sufficiently traced the accounts at issue, thereby meeting his evidentiary burden. The Court of Appeal's ruling in *Ciprari* should be a reminder to us all that a "one-size fits all" approach to litigation does not work and practitioners should remain limber in their analysis—both when preparing tracings or disputing the other side's analysis.

Application of 4320 Factors. One of the other issues tackled by the Court of Appeal arises from the trial court's failure to issue Family Code 4320 findings when it set wife's permanent support at $5,000 per month. The Court of Appeal criticized the trial court for failing: (i) to explain why it was just and reasonable to set permanent support at $5,000 per month; (ii) to identify evidence to support its conclusion that the support order was sufficient to meet wife's needs; and (iii) to relate the support order back to the parties' marital standard of living. Based upon these failures, the Court of Appeal reversed and remanded the support order for recalculation and clarification. The lesson to be learned here is straightforward: it is incumbent upon all of us to protect our records (and our clients) by reminding judges to make these necessary and critical findings when issuing rulings setting support.

Thus, in one opinion, the Court of Appeal both opened the door to more creative "outside the box" methods to tracing separate property, while still underscoring the fundamental importance of dotting your i's and crossing your t's when seeking judicial orders.

Commentary

Vanessa Kirker Wright

Wow—what a case! I was particularly interested in the practice points related to tracing and claims of breach of fiduciary duty. First up: tracing.

The holding on tracing basically just tells us that direct or indirect methods are acceptable but not exclusive, and a trial court's discretion extends to the authority to credit reasonably well-supported non-speculative expert theories [*citing* Sargon Enterprises,