

## OPTIONS FOR SETTLEMENT WHEN THE MARITAL ESTATE IS UPSIDE DOWN

BY KATHERINE SU, ESQ. AND FRIEDA GORDON, ESQ.

The process of obtaining a legal separation or divorce is already a highly stressful and emotionally draining process for the Parties involved. In addition to adjusting to their newly single lives, there may also be the issues of child custody, child visitation, child support, spousal support, property division, and/or attorney's fees and costs involved. These issues (where applicable) must of course be resolved one way or another, whether through litigation or a settlement agreement, before a Judgment can be reached, and before the Parties can truly move on with their lives.

While these issues are already difficult and complicated enough to resolve, in today's economic climate, many couples going through the legal separation or divorce process are finding that the issue of property division is further complicated due to the fact that the community estate is "upside down". This is a situation in which the total debts of the community estate exceed the total value of the assets of the community estate. Thus, even if the Parties were to liquidate all of the community assets, they would not be able to satisfy all of the community debts. To resolve this increasingly common problem in today's times, Parties and/or the attorneys have been forced to find creative solutions to resolving the problem of the upside down community estate.

There are various options available to those Parties who are seeking settlement of the issue of property division which are not otherwise available to those Parties who are allowing the courts to decide the issue. This is due to the fact that pursuant to *California Family Code* Section 2550, Parties are permitted to stipulate to an unequal division of the community estate. Without the agreement of the Parties to an unequal division of community estate, the courts are bound by *California Family Code* Section 2550 to divide the community estate of the parties equally. In other words, while the courts must award and/or divide the community assets and debts so as to effect an overall equal division of the community estate,

Parties may *agree* to an allocation and/or division of the community assets and debts which are *not* generally equal, thereby giving the Parties more freedom to devise creative ways of allocating the community's assets and debts to effect the most fair division of the community estate, that are otherwise available to those Parties going through the litigation process.

For example, Husband and Wife's only community assets and debts are a house which is worth \$400,000, encumbered by a \$500,000 purchase money mortgage, and a bank account with a balance of \$200,000. Husband agrees to give the house to Wife, subject to the mortgage secured by the residence. Pursuant to *California Family Code* Section 2550, if the house and mortgage are assigned to Wife, the Court would theoretically be required to award \$150,000 of the \$200,000 in the bank account to Wife as well. This is because, despite the fact that Wife is receiving the home, she is also being assigned the mortgage on the home which exceeds the value of the home by \$100,000. In effect, this means that Wife's net in this assignment is -\$100,000, while Husband's net, receiving neither property or debt through this assignment, is zero. To ensure an *equal overall division* of the community property, the Court would be required to award \$150,000 to Wife of the bank account funds and only \$50,000 to Husband, so that Wife's net would be \$50,000 (despite receiving the house as well) while Husband's net was also \$50,000. But of course, if Wife then short sold the home or the lender was otherwise willing to forgive all or a portion of the loan, the benefit received to Wife from this "equal" division of the community estate would actually be greater than one-half. On the other hand, if the Parties were settling the issue of property division, they could agree to give the house to Wife, subject to the mortgage, but to assign a "zero" value to the home, and then they could simply divide the bank account equally. This division, while technically not *mathematically equal*, would be an otherwise fair division of the community assets and debts, as it was Wife's *choice* to take the home with the encumbrance. If she goes into default, she could simply execute a deed in lieu of foreclosure whereby she would transfer all interest in the home to the lender and avoid foreclosure. Since the mortgage is a *purchase money mortgage*, the debt is a no-

recourse loan, and therefore, the loan would be satisfied, and Wife would be no worse off by her assumption of the debt if it became due (e.g., she defaulted.)

The Parties entering into a settlement agreement could also agree to include a provision in their settlement agreement that reserves the Court's jurisdiction to divide and award a particular asset for a certain period of time. Thus, the Parties could divide the remainder of the community estate, while continuing to hold some assets and/or debts outstanding to wait for conditions to improve prior to division. For example, again using the scenario discussed above, the Parties could agree to divide the bank account equally, reserving jurisdiction over the division and/or allocation of the house and the mortgage. The Parties could then wait for the house's value to increase sufficiently to either "break even" on a sale of the home or even profit from it.

When the Parties are entering into a settlement agreement with regard to an upside down community estate, the Parties could also agree to an unequal division of the community estate in exchange for waiving other rights. For example, the Parties could agree for one spouse to assume a larger portion of the community debt in exchange for the other spouse's waiver of the right to spousal support. The Parties could also agree for one or both of the Parties to pay the premiums for an annuity, and agree to use the proceeds of the annuity to pay certain community debts. If the Parties agree to a certain allocation of debts to each Party, the Parties could agree to indemnify the other Party for any liability arising out of the responsible Party's failure to pay the community, including the requirement that the responsible Party obtain a bond for the debt amount or that he or she maintain a life insurance policy on himself or herself naming the other Party the beneficiary, so that in the event of the responsible Party's death, the surviving Party would receive funds sufficient to satisfy the debt.

Our firm has handled and continues to handle countless cases involving negative asset estates as well as complicated tracing and commingling issues in divorce situations. We would be happy to consult with you as the

prospective client regarding these types of issues and look forward to having the opportunity to answer your questions and provide you with a plan for achieving your desired result in this regard.