

# Fraud and Waste Claims in Texas Divorces

*“A House Divided” Property Division Seminar - April 29, 2014*

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The division of community property in a Texas divorce can be effected by claims of fraud made by one spouse against the other. “Actual fraud” involves intentional misrepresentation and “constructive fraud” involves secret or unauthorized transfers of community funds. Sec. 7.009(c) of the Texas Family Code now provides a list of remedies for fraud.

## 1. Actual Fraud

Actual fraud is not often asserted in divorce cases because it is harder to prove than constructive fraud. The spouse alleging actual fraud has the burden of proof. On the other hand, an allegation of constructive fraud changes the burden of proof to the spouse who made the transfers to show the transfers were fair.

Actual fraud involves dishonesty of purpose or intent to deceive and requires proof that a transfer of community property was made with the primary purpose of depriving the other spouse from having the use and enjoyment of the assets. *Horlock v. Horlock*, 533 S.W.2d 52, 55 (Tex. App. - Houston [14th Dist.] 1975, writ dismissed). In contrast, wrongful intent does not have to be proven for a constructive fraud claim. *Puntarelli v. Peterson*, 405 S.W.3d 131, 138 (Tex. App. - Houston [1st Dist.] 2013, no pet.).

Actual fraud is more likely to be asserted in a divorce case against a third party, such as a girlfriend or relative, who has helped a spouse transfer or hide community funds (see discussion below of third party claims).

## 2. Constructive Fraud

Constructive fraud, waste and breach of fiduciary duty all mean basically the same thing in the context of a divorce. See also *Ricks v. Ricks*, 169 S.W.3d 523, 526 (Tex. App. - Dallas 2005, no pet.). The court in *Puntarelli v. Peterson*, 405 S.W.3d 131, 138 (Tex. App. - Houston [1st Dist.] 2013, no pet.) said, “A fiduciary duty exists between a husband and a wife as to the community property controlled by each spouse. A presumption of constructive fraud, i.e., waste, arises when one spouse disposes of the other spouse’s interest in community property without the other’s knowledge or consent.”

Constructive fraud is presumed when one spouse during the marriage transfers community property outside of the community without the other spouse’s knowledge or consent. *Knight v. Knight*, 301 S.W.3d 723, 731 (Tex. App. - Houston [14<sup>th</sup> Dist.] 2009, no pet.).

“Transfer” can include transfer to a third party, excessive gifts to third parties and use of community property to benefit a spouse’s separate estate. *In re Marriage of Notash*, 118 S.W.3d 868, 873 (Tex. App. - Texarkana 2003, no pet.).

Once alleged by the complaining spouse, the responding spouse carries the burden of rebutting the presumption of constructive fraud by proving the fairness of the transaction. See *Mazique v. Mazique*, 742 S.W.2d 805, 807 (Tex. App.—Houston [1st Dist.] 1987, no writ).

The factors that the court can consider in determining whether or not a spouse's actions constitute constructive fraud are:

1. the relationship between the spouse and the recipient;
2. the size of the gift or transfer in relation to the total size of the community estate;
3. the adequacy of the estate remaining to support the other spouse in spite of the gift or the transfer; and
4. any special justifying factors for the gift or transfer.

*Massey v. Massey*, 807 S.W.2d 391, 402 (Tex. App. - Houston [1st Dist.] 1991), writ denied, 867 S.W.2d 766 (Tex. 1993) (per curiam).

No dishonesty of purpose or intent to deceive need be established for the Court to find constructive fraud. *Puntarelli v. Peterson*, 405 S.W.3d 131, 138 (Tex. App. - Houston [1st Dist.] 2013, no pet.).

A spouse accused of constructive fraud has the burden to prove that the transfer was "fair." *Wright v. Wright*, 280 S.W.3d 901, 911-12 (Tex. App. - Eastland 2009, no pet.).

Examples of spousal misbehavior which has been held to be constructive fraud include:

- The husband's gifts to the educational funds for the children of the marriage were held to be constructive fraud, even though wife knew, but was not fully informed, of the gifts. *In re McCurdy's Marriage*, 489 S.W.2d 712 (Tex. Civ. App.—Amarillo 1973, no writ).
- The husband used community property to fund a trust for his son from a former marriage and the gift was held to be constructive fraud because the husband failed to meet his burden and prove that that the disposition was fair to Wife. *Grant v. Grant*, No. 01-98-00352-CV, (Tex. App. - Houston [1st Dist.], Nov. 24, 1999, no writ) (mem. op.).
- The husband replaced wife as beneficiary of life insurance policy with his girlfriend. The insurance proceeds were held to be community property and the change in beneficiary was held to constitute constructive fraud on the wife's share of the community estate in the absence of a showing of "special justifying factors." *Givens v. Girard Life Ins. Co. of America*, 480 S.W.2d 421 (Tex. Civ. App.—Dallas 1972, writ ref'd n.r.e.)
- The naughty husband went to Puerto Rico with approximately \$53,000, but he testified that he lost some of it gambling and that he gave some of it away, that he spent it very foolishly and that at the time of the trial he did not have any of it. The Court held that "...in the light of the undisputed facts in this case the trial court could not make a fair and just division of the remaining community assets without taking into account Appellant's profligate loss of a large portion of the community estate." *Reaney v. Reaney*, 505 S.W.2d 338, 340 (Tex. Civ. App. - Dallas 1974, no writ) .
- During a twenty-five year marriage, the husband engaged in numerous extramarital affairs which he funded with community funds and he paid for trips, meals, gifts, and hotels for the third parties with community funds. No accounting of the gifts was made to the wife. The trial court found the husband had committed constructive fraud and the ruling was upheld by the Court of Appeals. *Mazique v. Mazique*, 742 S.W.2d 805 (Tex. App. - Houston [1st Dist.] 1987, no writ).

An example of gifts to children from a prior marriage which were held to not be constructive fraud was *Marshall v. Marshall*, 735 S.W.2d 587 (Tex. App.—Dallas 1987, writ ref'd n.r.e.) (wife's claim of constructive fraud for husband's gifts to his children from a prior marriage was denied where gifts were equal to 11 percent of the husband's total earnings during their brief marriage, and where wife was advised of the gifts and although she did not actively consent, she raised no objection to the gifts at the time they were made).

### 3. Puntarelli v. Peterson - “Where Did All Those Earnings Go?”

A recent decision from the First Court of Appeals out of Judge Bonnie Hellums’ court (won by Michael Childs) provides a new twist to claims of waste or constructive fraud. In *Puntarelli v. Peterson*, 405 S.W.3d 131 (Tex. App. - Houston [1st Dist.] 2013, no pet.), the wife asked the age old question “where did all of the money he earned go?” The wife was awarded a \$196,000 judgment for wasting community funds because the husband could not account for how he spent his significant income during the five years this informal marriage/divorce case was pending. **The important holding from this case is this – the wife did not have to prove any specific improper transfers of community funds. The wife merely had to show that the husband’s expenses were much less than his income and then the burden shifted to the husband to show where the money went.** Proving how one spent money years ago is often not easy, but failure to do so can result in a large judgment, as happened here. Of course, the husband did not help himself by failing to disclose his primary bank account in his sworn inventory or by failing to support the common law spouse during the pendency of the case. The Court of Appeals stated (citations omitted):

*While waste claims often are premised on specific transfers or gifts of community property to a third party, a waste judgment can be sustained by evidence of community funds unaccounted for by the spouse in control of those funds.*

....

*The trial evidence that Puntarelli failed to disclose at least one bank account containing community funds into which his income was deposited, along with his failure to account for or explain the depletion of the community funds in his control over the five-year pendency of the divorce proceedings spent without Peterson’s consent was sufficient to shift the burden to Puntarelli to establish the fairness of his use of these community funds. He did not attempt to meet this burden.*

*Because we have rejected Puntarelli’s argument that Peterson needed to identify specific transfers of community property (rather than identifying unaccounted-for community funds in Puntarelli’s sole control) to shift the burden to Puntarelli to show the fairness of his use of those funds in his control, and because Puntarelli does not otherwise challenge the trial court’s waste judgment or argue that he established his depletion of community assets was fair to Peterson, we hold that the trial court’s waste judgment was within its discretion.*

So, a spouse in a divorce can compare the other spouse’s income to his or her expenses for a specific time period and if there is a significant gap between income and expenses, allege fraud and then sit back and see if he or she can prove how the funds were spent. One tool in such cases is the Financial Information Statement submitted early on in a case at the hearing on temporary orders. If the husband’s FIS shows his monthly expenses are \$6,200 and he brings home \$11,000 a month and yet has no money in savings, the wife should allege constructive fraud and then the husband has the burden to prove how the money was spent. In such a case, the attorney for the husband could use bank and credit card statements and a chart summarizing expenditures to prove the money was all spent for legitimate purposes.

#### 4. Fraud Can Be a Jury Issue

The *Texas Pattern Jury Charges - Family 2012* contains suggested jury instructions and questions related to fraud. For example, this is the suggested instruction and question on constructive fraud by a spouse against the community estate:

206.4A

*A spouse may make moderate gifts, transfers, or expenditures of community property for just causes to a third party. However, a gift, transfer, or expenditure of community property that is capricious, excessive, or arbitrary is unfair to the other spouse. Factors to be considered in determining the fairness of a gift, transfer, or expenditure are—*

1. *The relationship between the spouse making the gift, transfer, or expenditure and the recipient.*
2. *Whether there were any special circumstances tending to justify the gift, transfer, or expenditure.*
3. *Whether the community funds used for the gift, transfer, or expenditure were reasonable in proportion to the community estate remaining.*

206.4B

##### QUESTION 1

*Was the transfer made by PARTY A to THIRD PARTY fair?*

*Answer “Yes” or “No.”*

*Answer: \_\_\_\_\_*

- If you answered “No” to Question 1, then answer Question 2. Otherwise, do not answer Question 2.*

##### QUESTION 2

*State in dollars the value, if any, by which the community estate of PARTY A and PARTY B was depleted as a result of the transfer made by PARTY A to THIRD PARTY.*

*Answer: \$ \_\_\_\_\_*

#### 5. Remedies for Fraud Against a Spouse

The Texas Supreme Court in *Schlueter v. Schlueter*, 975 S.W.2d 584 (Tex. 1998) held that there is no independent tort cause of action between spouses for damages to the community estate. In *Schlueter* the husband transferred various community assets to his father shortly before he filed for divorce. The wife brought independent tort claims against her husband and father-in-law, seeking damages for fraud, breach of fiduciary duty and conspiracy in her counterclaim for divorce. Based on favorable jury findings the trial court ordered a disproportionate division of the community estate in favor of the wife and rendered judgment for the wife against the husband and his father for actual and exemplary damages. Because a wronged spouse has an adequate remedy for fraud on the community through the “just and right” property division upon divorce, the Court reversed the tort judgment against the husband and remanded the case for a new division of the marital estate.

The Texas Family Code now provides specific guidance on how a divorce court can remedy fraud committed by one spouse on the other. Section 7.009 states:

**7.009. FRAUD ON THE COMMUNITY; DIVISION AND DISPOSITION OF RECONSTITUTED ESTATE**

*(a) In this section, “reconstituted estate” means the total value of the community estate that would exist if an actual or constructive fraud on the community had not occurred.*

*(b) If the trier of fact determines that a spouse has committed actual or constructive fraud on the community, the court shall:*

*(1) calculate the value by which the community estate was depleted as a result of the fraud on the community and calculate the amount of the reconstituted estate; and*

*(2) divide the value of the reconstituted estate between the parties in a manner the court deems just and right.*

*(c) In making a just and right division of the reconstituted estate under Section 7.001, the court may grant any legal or equitable relief necessary to accomplish a just and right division, including:*

*(1) awarding to the wronged spouse an appropriate share of the community estate remaining after the actual or constructive fraud on the community;*

*(2) awarding a money judgment in favor of the wronged spouse against the spouse who committed the actual or constructive fraud on the community; or*

*(3) awarding to the wronged spouse both a money judgment and an appropriate share of the community estate.*

So, assume that the current value of the community estate is \$400,000 at the time of divorce trial and the court finds that the wife committed constructive fraud in the amount of \$60,000 against the community estate. The “reconstituted” estate is thus worth \$460,000. The judge’s options are:

1. Award the husband more than 50 % of the community estate while “pretending” the wife still has the \$60,000, which will result in more real assets being awarded to the husband;
2. Awarding the husband a judgment against the wife for some fair portion of the \$60,000. Remember, the wife waste community funds so she also waste money that belonged to her as well, so the husband would almost certainly not get a judgment for the full \$60,000.
3. Award both a money judgment and a disproportionate share of the community estate to the husband.

## 6. Constructive Fraud on the Property Division Spreadsheet

If, for example, a spouse wasted funds on a paramour or cannot account for a large amount of cash, list that as an asset (“funds wasted by Wife” or “cash unaccounted for”) and then award the asset to the spouse who wasted the money or cannot account for the cash. This will have the effect of giving more real, existing assets to the other, injured spouse. You are in effect pretending the spouse who wasted the funds still has the money and so, he or she will actually get less in the final division. An example of showing fraud or waste on the property division spreadsheet would be:

Property or Debt	Value	Husband	Wife
Cash taken by wife not accounted for	\$60,000.00		\$60,000.00

## 7. Claims Against Third Parties

### A. Tort Claims

A wife cannot sue her husband for fraud as a separate tort in a divorce suit but the wife can join the husband’s mistress as a third party defendant and allege fraud and conspiracy. Claims against third parties for fraudulently taking community property are allowed after *Schlueter*. *Chu v. Hong*, 249 S.W.3d 441, 445 (Tex. 2008)(“...if a third party steals community property, surely either spouse or both can seek recovery in tort for it.”). *Chu v. Hong* does hold that if a spouse sells community property but still has the proceeds from the sale, the other spouse cannot sue the third parties who bought the community property – the remedy is to go after the spouse who did the selling.

In *Osuna v. Quintana*, 993 S.W.2d 201 (Tex. App.—Corpus Christi 1999, no writ, the court upheld a joint and several judgment against husband and mistress for the amounts of community funds that the husband gave to his mistress.

Examples of tort claims against third parties who received the community property include *Stevenson v. Koutzarov*, 795 S.W.2d 313 (Tex. App.—Houston [1st Dist.] 1990, writ denied)(recovery for conversion of community property against wife’s friends upheld) and *Mayes v. Stewart*, 11 S.W.3d 440 (Tex. App.—Houston [14th Dist.] 2000, pet. denied)(after divorce, wife sued husband and a woman who helped the husband hide the fact that he had won the lottery. The wife’s claim for fraud against the third party was upheld).

*West v. West*, 01-11-00051-CV (Tex. App. - Houston [1<sup>st</sup> Dist.] 2/9/2012)(mem. op.) affirmed a wife’s recovery against her husband’s parents for conspiring with her husband to defraud her out of community property. The wife alleged that her husband and her former in-laws tricked her into believing that she was making payments on a property she and her husband were buying when in fact the parents owned the property and no sale had taken place.

Usually, a defrauded spouse in a divorce would sue a third party, such as his or her spouse’s paramour, business partners or relatives, for fraud, conversion and conspiracy.

The elements of conversion are:

1. The plaintiff owned, possessed or had the right to immediate possession of personal property;
2. The defendant wrongfully exercised dominion or control over the property;
3. The plaintiff suffered injury.

*Burns v. Rochon*, 190 S.W.3d 263, 267-8 (Tex. App. - Houston [1<sup>st</sup> Dist.] 2006, no pet.). Funds held in a bank account can be personal property subject to conversion. *Estate of Townes v. Townes*, 867 S.W.2d 414, 419 (Tex. App. - Houston [14<sup>th</sup> Dist.]1993, writ denied).

The elements of conspiracy are:

1. The defendant and one or more persons (i.e. - the other spouse);
2. Had a meeting of the minds to take an action;
3. The action was unlawful or constituted an intentional tort, such as fraud or conversion;
4. One of the members of the group committed the unlawful, overt act to further the action; and
5. The action proximately caused injury to the plaintiff.

*Chon Tri v. J.T.T.*, 162 S.W.3d 552, 556 (Tex. 2005).

In a suit against a third party, the injured spouse might allege common-law fraud, fraud by deception or statutory fraud (involving stock or real estate).

Common-law fraud requires proof of:

1. The defendant made a material and false representation to the plaintiff;
2. The defendant knew the representation was false or made the representation recklessly, as a positive assertion, without knowledge of its truth;
3. The defendant made the representation with the intent that the plaintiff act on it;
4. The plaintiff relied on the representation and suffered injury.

Statutory Fraud is based on Texas Business & Commerce Code Sec. 27.01 and must involve stocks or real estate. Statutory fraud is basically the same as common-law fraud except the plaintiff does not have to prove that the defendant knew the representation was false or made the representation recklessly. *Henning v. One West Bank*, 405 S.W.3d 950, 963 (Tex. App. - Dallas 2013, no pet.).

To establish fraud by nondisclosure, appellants must prove:

1. the defendant failed to disclose facts to the plaintiff,
2. the defendant had a duty to disclose those facts,
3. the facts were material,
4. the defendant knew the plaintiff was ignorant of the facts and the plaintiff did not have an equal opportunity to discover the facts,
5. the defendant was deliberately silent when it had a duty to speak,
6. by failing to disclose the facts, the defendant intended to induce the plaintiff to take some action or

refrain from acting,

7. the plaintiff relied on the defendant's nondisclosure, and
8. the plaintiff was injured as a result of acting without that knowledge.

*Horizon Shipbuilding, Inc. v. Blyn II Holding, LLC*, 324 S.W.3d 840, 850 (Tex. App. - Houston [14th Dist.] 2010, no pet.).

## B. Constructive Trust

A constructive trust is an equitable remedy created by the courts to prevent unjust enrichment or to compensate the victim of a breach of a fiduciary or confidential relationship. *In re Marriage of Loftis*, 40 S.W.3d 160 (Tex. App.—Texarkana 2001, no pet.). The court will impose a constructive trust over an asset fraudulently conveyed if it is unique or if the estate is inadequate and the asset must be returned to the estate to effect an equitable division. *Hudspeth v. Stoker*, 644 S.W.2d 92 (Tex. App.—San Antonio 1982, writ ref'd). *Hudspeth v. Stoker*, involved a husband who changed life insurance beneficiary from his former wife to new wife violated his legal duty under the divorce decree and trial court was justified in imposing constructive trust on the proceeds of the policy.

## 8. Diversion of Community Opportunity

What if the husband owns a separate property corporation that owns several bars and during the marriage he uses that entity to start a new restaurant when he could just have easily used community property and made the restaurant a community asset? A legal theory sometimes suggested by clever lawyers is called “Diversion of Community Opportunity” or the “Community Opportunity Doctrine.” This theory would suggest that the husband in the above example breached his fiduciary duty to his wife and therefore the loss of that new valuable asset to the community estate should be considered in the property division. No Texas cases have adopted that theory and in fact, one older case, *Holloway v. Holloway*, 671 S.W.2d 51, 59-60 (Tex. App. - Dallas 1983, no writ), appears to have rejected that argument.

Here is what one very smart lawyer wrote about this theory over a decade ago and his analysis seems to hold true today:

*In Holloway v. Holloway*, 671 S.W.2d 51, 59-60 (Tex. App. -Dallas 1983, no writ), the wife accused the husband, as manager of the community estate, of unjustly enriching his separate estate by diverting community funds into separate corporations. Specifically, the wife argued that the husband breached a fiduciary duty owed to the community estate by using separate funds to capitalize the corporations when there were adequate funds in the community estate. *Id.* at 59. However, the Dallas Court of Appeals refused to agree with the wife, stating that 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. *Id.* If the venture turns out to be successful, as it did in *Holloway*, the Dallas appellate court determined that the husband could not be held guilty of breach of a fiduciary duty in the absence of evidence of an intent to defraud the wife. *Id.* at 59-60.

*Holloway* has been criticized as contrary to the basic principles of the community property system. See, Donald R. Smith, *Diversion of Community Opportunity*, *ADVANCED FAMILY LAW COURSE* (1986). Further, it has been suggested that the theory of “diversion of community opportunity” is meritorious, and should be investigated by the practitioner in the proper case. Cheryl L. Wilson, *Breach of Fiduciary Duty*, p. M-7, *16TH ANNUAL MARRIAGE DISSOLUTION INSTITUTE* (1993). It should be noted,



*however, that there appears to be no reported Texas case recognizing the diversion of community property theory.*

Ted Terry, et al, “Fiduciary Duties of Spouses and Non-Physical Torts” presented at the Annual Meeting of International Academy of Matrimonial Lawyers in March 2000.

Justice Anne McClure in *Sprick v. Sprick*, 25 S.W.3d 7, 15, note 3 (Tex. App. – El Paso 1999, pet. denied) mentioned the doctrine but it was clearly an aside in her concurring opinion:

*The community opportunity doctrine derives from the corporate opportunity doctrine and stands for the proposition that a spouse has an obligation to maximize the community estate by taking advantage of an opportunity to invest in a lucrative venture using community, rather than separate, funds.*

Texas clearly recognizes the corporate opportunity doctrine, as do most other states. *Imperial Group (Texas), Inc. v. Scholnick*, 709 S.W.2d 358, 365 (Tex. App. – Tyler 1986, writ ref’d n.r.e.); *Alexander v. Sturkie*, 909 S.W.2d 166 (Tex. App. - Houston [14 Dist.] 1995, writ denied).

The corporate opportunity doctrine has been explained as follows:

*The corporate opportunity doctrine embodies one of the fiduciary duties owed by directors and officers (and sometimes shareholders) to their corporation. It is a duty of disclosure under the concept of duty of loyalty. Although the doctrine itself requires a fact intensive analysis, the theory behind it is simple. The corporation can act only through its human agents. When an opportunity within the corporation's line of business, or its reasonable expansion or expectancy, comes to an agent's attention, the agent must afford the corporation first crack at it. For example, if a corporation is in the business of buying and selling real estate, and its president (or a director or perhaps a major shareholder) learns of a tract of land that can be bought for a song and flipped at a profit, it is incumbent on the agent to disclose to the corporation the possibility of cashing in on this fantastic opportunity. If the corporation declines, perhaps because the transaction may be viewed by its board as more risky than fantastic, the agent may then seize it personally for better or worse.*

Parchman, “Fiduciary Duties: Renouncing the Corporate Opportunity Doctrine,” *Business Law Today*, October 2011.

The “Corporate Opportunity Doctrine” is founded on the fiduciary duty owed by directors and officers to the corporation. Texas recognizes that spouses during a marriage owe each other a fiduciary duty. *Marsh v. Marsh*, 949 S.W.2d 734, 745, n. 4 (Tex. App. - Houston [14th Dist.] 1997, no writ). It certainly seems arguable, therefore, that what is good for corporations should also be used to protect spouses. Thus, the violation of the “Community Opportunity Doctrine” should be a viable claim in some divorces.

## **9. Fraud is a Factor in Spousal Maintenance**

Fraud can be a factor for the trial court to consider in determining the amount and duration of post-divorce spousal maintenance. Texas Family Code Sec. 8.052 states:

*A court that determines that a spouse is eligible to receive maintenance under this chapter shall determine the nature, amount, duration, and manner of periodic payments by considering all relevant factors, including: . . .*

*(6) acts by either spouse resulting in excessive or abnormal expenditures or destruction, concealment, or fraudulent disposition of community property, joint tenancy, or other property held in common;*