INJURY SETTLEMENTS ARE USUALLY COMMUNITY PROPERTY IN A TEXAS DIVORCE

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A spouse's recovery for an injury claim is usually community property because most settlements mix all of the damage elements together in a single payment.

General Principles

Recoveries in injury claims are treated like other property in a divorce and the usual presumptions and burdens of proof apply. When a spouse receives a settlement from a lawsuit during the marriage, some of which could be separate property and some of which could be community property the burden of proof is on the spouse claiming the funds as separate property. *Kyles v. Kyles*, 832 S.W.2d 194,198 (Tex. App. - Beaumont 1992, no pet). All property is presumed to be community property and "clear and convincing evidence" must be presented to establish that property is separate property. Tex Fam. Code §3.003.

The Texas Family Code provides in its definition of separate property:

Sec. 3.001. SEPARATE PROPERTY. A spouse's separate property consists of: ....

(3) the recovery for personal injuries sustained by the spouse during marriage, except any recovery for loss of earning capacity during marriage.

The Texas Family Code also states that all property a couple has at the time of divorce is presumed to be community property:

3.003. PRESUMPTION OF COMMUNITY PROPERTY.
(a) Property possessed by either spouse during or on dissolution of marriage is presumed to be community property.
(b) The degree of proof necessary to establish that property is separate property is clear and convincing evidence.

Specific Elements of Damages

The following elements of damages have been held to be separate property:

- Mental pain and anguish, *Moreno v. Alejandro*, 775 S.W.2d, 735,737 (Tex. App. - San Antonio 1989, writ denied).
- Physical pain and suffering, *Graham v. Franco*, 488 S.W.2d 390, 396 (Tex. 1972).
- Disfigurement, *Graham v. Franco*, 488 S.W.2d 390, 396 (Tex. 1972).
- Loss of a spouse's love and companionship, *Osborn v. Osborn*, 961 S.W.2d 408, 414 (Tex. App. - Houston [1st Dist.] 1997, writ denied).

The following elements of personal injury damages have been found to be community property:

- Loss of earning capacity during marriage, *Perez v. Perez,* 587 S.W.2d 671,673 (Tex. 1979)
- Medical expenses incurred during the marriage, *Licata v. Licata*, 11 S.W.3d 269, 273 (Tex. App. - Houston [14th Dist.] 1999, no pet).
- Damage to credit reputation, *Douglas v. Delp,* 987 S.W.2d 879, 883 (Tex. 1999).
- "Other expenses associated with the injury to the community estate," *Osborn v. Osborn*, 961 S.W.2d 408, 414 (Tex. App. - Houston [1st Dist.] 1997, writ denied). Presumably, this would include damages to community property such as the family automobile.
- Disability insurance payments and workers' compensation benefits are community property, "...to the extent it is intended to replace earnings lost while the disabled or injured person is married." Texas Family Code §3.008(b).

An old Texas case says punitive or exemplary damages are community property and a new case from 2011 says punitive damages are separate property (see discussion below).

Lump Sum Settlements are Usually Community Property

The basic rule in Texas is that a lump sum injury recovery is all community property if a party cannot prove what part of the lump sum settlement is separate property. See, e.g. *Kyles v. Kyles*, 832 S.W.2d 194 (Tex. App. - Beaumont 1992, no pet); *Patt v.Patt*, 689 S.W.2d 505 (Tex. App. - Houston [1st Dist.] 1985, no writ); and *York v. York*, 579 S.W.2d 24 (Tex. Civ. App. - Beaumont 1979, no writ).

As one court has said, " Without clear and convincing evidence showing the recovery is solely for the personal injury of a particular spouse, the spouse does not overcome the presumption that all recovery received during marriage is community property." *Licata v. Licata*, 11 S.W.3d 269, 273 (Tex. App. - Houston [14th Dist.] 1999, no pet).

In *Kyles v. Kyles*, 832 S.W.2d 194 (Tex. App. - Beaumont 1992, no pet), the husband was injured in a car wreck and filed a lawsuit seeking various damages, including lost wages and lost earnings capacity. An unsigned copy of the release was introduced which had signature lines for both spouses and which stated the release was for, "all sums of any kind or character, including by way of illustration, but not by way of limitation, actual damages sustained by claimant; exemplary damages; medical hospital, drug or nursing bills; prosthetic devices; property damages; loss of wages or profits..." The trial court found that the entire recovery was the husband's separate property and that it did not include any recovery for loss of earning capacity, medical expenses or property damage. The court of appeals reversed and ruled that the husband failed to rebut the presumption that the recovery was community property, stating:

> *All property possessed during marriage or on dissolution of marriage is presumed to be community property, and the party claiming that such property is separate, must prove so by clear and convincing evidence. Thus appellee has the burden of proving that the original settlement was his separate property....*
>
> *We are hard put from the record to find clear and convincing evidence proffered by appellee to rebut the presumption that the settlement proceeds were community property. Without evidence to the contrary, it must be presumed that at least some of the settlement proceeds were*

attributable to lost wages or lost earning capacity which are community property. The only evidence we can find from the record which comes close to addressing the issue, comes from appellee's testimony that it was his understanding that the entire settlement was for personal injuries and nothing else. However, in earlier testimony, appellee testified as follows:

Q: How much of that settlement was due to your lost wages in income?

A: I don't know.

Q: Some of it was, was it not?

A: It would have to be, it wasn't spelled out how much.

....

Q: You couldn't say one way or the other? You couldn't deny it, part of it was for lost wages?

A: I still don't know.

Since appellee did not prove what amount, if any, of the settlement proceeds were separate or community property, it must be conclusively presumed that the entire proceeds are community property. When a spouse receives a settlement from a lawsuit during a marriage, some of which may be separate property and some of which may be community property, it is the spouse's burden to demonstrate what portion of the settlement is his separate property. *Moreno v. Alejandro, 775 S.W.2d 735, 738 (Tex. App. - San Antonio 1989, writ denied).* ***This Court has previously held that a spouse that receives a settlement arising out of a personal injury has a burden to show that none of the funds constitute payment for lost wages or lost earnings capacity during marriage. In the absence of such evidence, the entire settlement proceeds are property characterized as community property.*** *York v. York, 579 S.W.2d 24, 25-26 (Tex. Civ. App. - Beaumont 1979, no writ), see also, Patt v. Patt, 689 S.W. 2d 505, 509-510.*

Kyles, 832 S.W.2d at 198 (emphasis added).

In *Franklin v. Franklin*, 07-04-00515-CV (Tex. App. - Amarillo 6/19/2006)(mem. op.), the husband settled a phen phen lawsuit in which he sought past and future physical pain and mental anguish, disfigurement and medical expenses. The trial court and then the Court of Appeals held that annuity payments to the husband that were part of the injury settlement were community property. The Amarillo Court of Appeals stated:

...we deal here with an asset acquired during marriage from the settlement of a lawsuit in which both Robert's separate property claims and community property claims were asserted and settled. The trial court here properly placed on Robert the burden to show that the annuity he claimed as separate property was obtained as a result of his personal injuries and was not compensation for lost earning capacity during marriage or medical expenses.

The trial court's ruling that the annuity was community property was upheld in the *Franklin* case because the husband was not able to prove how much of the settlement was for each item of damages.

The husband argued that all of his medical expenses incurred during the marriage had been paid using the settlement recovery and thus under the "community out first" rule, he had proven that what was left was his separate property. That argument was rejected by the Court of Appeals, which said, "...that evidence says little or nothing about the amount, or the proportion of the total settlement, for which the medical expense claim was settled." In other words, the husband could not prove how much of the total settlement was for the community property medical expenses and thus the entire recovery had to be considered to be community property.

In *Munoz v. Munoz*, No. 08-01-00443-CV (Tex. App. - El Paso 12/19/2003)(mem. op.), the injured wife and her husband were both plaintiffs in the personal injury lawsuit. In their petition, they alleged that the wife suffered physical pain and anguish, lost earnings and earning capacity, medical expenses, physical impairment, and disfigurement. They also alleged damages for the husband's loss of consortium and services of his wife. The lawsuit settled for $662,500. After deducting out-of-pocket expenses, attorney's fees, unpaid medical expenses, the workers' compensation lien, and $2,000 in advances, the couple was paid $439,064.12. Both spouses signed the release of their claims for the settlement monies. The trial court found that the funds remaining from the settlement were the wife's separate property. On appeal, the husband argued that there was no evidence to determine which portion of the settlement funds represented compensation for which category of damages. The wife conceded that the couple's alleged lost earnings and earning capacity and medical expenses, were damages that were community property.

The Court of Appeals reversed and stated:

> *With regard to the personal injury settlement, the trial court found that the settlement was for the separate nature of Appellee's injuries, her pain and suffering, her mental anguish and her disfigured leg. The trial court also found that the remaining sum of the settlement unspent by the parties during marriage was the sole and separate property of Appellee. However, after reviewing the record, we find a lack of clear and convincing evidence to rebut the presumption that some portion of the settlement funds were attributable to Appellee's lost earnings and lost earning capacity which are community estate assets. Since Appellee did not prove what amount of the settlement proceeds were separate or community property, a reasonable trier of fact could not have formed a firm belief or conviction that the net recovery from the settlement was entirely Appellee's separate property.* ***When some portion of a settlement may be for lost wages or lost earning capacity, the spouse receiving the settlement has the burden to show that none of the funds constitute payment for lost wages or lost earning capacity during marriage. In the absence of such evidence, the entire settlement proceeds are properly characterized as community property.*** *Therefore, the trial court erred in its characterization of the settlement fund as Appellee's separate property.*
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> *Id.* (Citations omitted, emphasis added).

The one appellate case that is contrary to all of the above decisions is a 1997 decision from the First Court of Appeals, that is almost certainly not good law. The Court of Appeals in *Osborne v. Osborne*, 961 S.W.2d 408, 415 (Tex. App. - Houston [1st Dist.] 1997, no pet.) reversed the trial court's ruling that any recovery from a personal injury suit brought by both the husband and wife (which was still pending at the time of the divorce) was community property. The Court of Appeals stated that the injured husband was not required to prove how much of the recovery was his separate property. This

case can probably be explained by the fact that it was decided in the same year (but before) the Texas Legislature added Sec. 3.003 to the Texas Family Code, which codified the community property presumption. All of the cases cited above ignored the ruling in *Osborne* and held that a injury settlement is presumed to be community property unless there is clear and convincing evidence of how much is a spouse's separate property. The Amarillo Court of Appeals specifically refused to follow *Osborne* and pointed out it was not consistent with all other cases on the subject in *Franklin v. Franklin*, 07-04-00515-CV (Tex. App. - Amarillo 6/19/2006)(mem. op.).

The only cases in Texas in which part of a lump sum injury settlement was held to be separate property involved a stipulations on precisely how much of the settlement was apportioned to each element of damages - something that is almost never done in injury settlements.

In *Slaton v. Slaton*, 987 S.W.2d 180 (Tex. App. - Houston [14th Dist.] 1999, no pet.), the total net recovery was $450,000 and parties stipulated that $34,060 was for lost wages and medical expenses which were agreed to be community property. The parties then litigated over whether the rest of the recovery was either the wife's separate property or the husband's separate property based on what they claim they had suffered. They in effect agreed that the rest was separate property and so overcame the community property presumption.

Licata v. Licata, 11 S.W.3d 269 (Tex. App. - Houston [14th Dist.] 1999, no pet.), involved two releases which settled the injury claims and specifically said that the money being paid was for physical pain, mental anguish and disfigurement only. That stipulation was enough to overcome the community property presumption.

A case decided by the Austin Court of Appeals in 2011 also involved a stipulation that a recovery was separate property. *Harrell v. Hochderffer*, 345 S.W.3d 652 (Tex. App. - Austin 2011, no pet.) was a probate case in which a trust agreement signed by both spouses essentially stipulated that the amounts contributed by each spouse (which resulted from the proceeds of a settlement of a medical negligence suit against a nursing home) were their own separate property. The settlement agreement in the nursing home lawsuit also awarded each spouse his and her own separate recoveries and the lawsuit did not seek any element of damages that is considered community property. This was held to be sufficient evidence that each spouse's respective recoveries were their own separate property.

Punitive Damages

In dicta, an old case from the Amarillo Court of Appeals case states that an exemplary damages award was community property. *In re DeVine*, 869 S.W.2d 415, 429 (Tex. App.—Amarillo, 1993, writ denied). However, *DeVine* involved a $3,000 exemplary damage award in the divorce trial awarded to the husband against the wife for fraud she committed on the community estate – it did not involve a punitive damage award paid by some third party.

A case decided by the Austin Court of Appeals in 2011 basically says the *In re De Vine* case is limited to its facts and does not apply to a lawsuit against a third party in tort. *Harrell v. Hochderffer*, 345 S.W.3d 652 (Tex. App. - Austin 2011, no pet.). In the *Harrell* case, the majority said:

> *A recovery for personal injuries, such as the one at issue here, is expressly characterized as separate property under the family code, with a statutory exception for any recovery for loss*

of earning capacity during the marriage. See Tex. Fam. Code Ann. § 3.001(3). The only additional exceptions acknowledged by Texas courts are funds recovered for "medical expenses incurred during marriage, and . . . other expenses associated with injury to the community estate." Licata, 11 S.W.3d at 273. Unlike lost earning capacity and medical expenses, however, exemplary damages do not represent income to which the community is entitled or an expense for which the community is liable. An exemplary damages recovery is merely "a private windfall," levied for the public purpose of punishment and deterrence, and is not associated with an injury to the community estate. See Transportation Ins. Co. v. Moriel, 879 S.W.2d 10, 17 (Tex. 1994). Because an exemplary-damages award does not fall under any exception to the general rule that the recovery for personal injuries is separate property, such damages must be characterized as separate property under family code section 3.001(3). See Tex. Fam. Code Ann. § 3.001(3).

A case from Louisiana (a community property state with case law and statutes similar to Texas') holds that punitive damages are community property. *Morris v. Morris*, 685 So.2d 673 (La. App. 3 Cir. 1996). The court cited a Louisiana Supreme Court case that stated, "punitive damages are sums awarded apart from any compensatory or nominal damages…" Because punitive damages do not derive from the spouses personal injury, the Court reasoned that punitive damages did not fall under the Louisiana code that stipulates that damages due to personal injuries sustained during the existence of the community by a spouse are separate property, but are governed by the " 'omnibus clause' which clearly states that 'community property comprises: all other property not classified by law as separate property.'" The Court rejected the defendants argument that the exemplary damage should be pro rated between separate and community property in the same manner as the compensatory damages.

The Alaskan Supreme Court in 2000 reaffirmed an earlier decision that, "an award of punitive damages should be apportioned in the same manner as the underlying compensatory damage award." *Edelman v. Edelman*, 3 P3d 348, 354-55 (Alaska 2000).

Injury Settlements In The Real World

Insurance companies settle with plaintiffs using releases that are drafted to protect the insurance companies and their insureds and therefore those releases almost never apportion the settlement between various elements of damages. Here is the wording from a typical settlement release that lists every possible element of damages but which does not apportion the total settlement between those damages:

We, HUSBAND and WIFE, and our attorneys, heirs, executors, administrators, legal representatives, successors and assigns, for the consideration of Fifteen Thousand Dollars ($15,000.00) paid to HUSBAND and WIFE, the receipt of which is hereby acknowledged, do hereby finally and completely release, acquit and forever discharge DEFENDANT... from any and all claims, causes of action, liabilities, obligations and damages of every kind, of whatsoever nature, known or unknown, accrued or which may ever accrue, whether based in contract, tort or other stature, arising out of, resulting from or in any manner related to the MOTOR VEHICLE COLLISION ON [DATE]. This release extends to and includes, but is not limited to, all damages of every kind, compensatory, exemplary and statutory, occurring in the past or which may occur in the future for HUSBAND, WIFE or anyone else now claiming or whoever may be entitled to claim damages, including but not limited to, pain and suffering, mental anguish, physical illness, impairment and/or disability, pecuniary loss, loss of companionship

and society, loss of inheritance, emotional injury, hospital, medical, nursing, custodial and rehabilitation expenses; loss of enjoyment of life; disfigurement; medical care, loss of household services, loss of consortium, loss of affection, solace, companionship, society, assistance and sexual relationship, loss of parental consortium, funeral and burial expenses, and for all of the other complications, if such should ensue.

Typically, the spouses would sign the release and the insurance company would pay the settlement in one check payable to both spouses and their attorney. The check would be endorsed by the payees and would then be deposited into the trust account of the plaintiffs' attorney. The attorney deducts her fee and expenses and then pays the spouses in one check payable to both from the trust account. Usually, the issue of divorce arises years later.

In these typical situations, the settlement proceeds will almost always have to be considered community property according to the cases and principles set forth above. Here are the only situations where I can imagine that a spouse in a divorce would be able to prove with clear and convincing evidence how much precisely from the lump sum settlement was his or her separate property:

1. There is a stipulation as to how much was paid for each element of damages, either in the divorce case or as part of the injury settlement. The mediated settlement agreement, for example, that resolves the injury claim could state that,"... the plaintiffs agree as to them that $22,000 of the above $105,000 settlement shall be considered community property and $83,000 shall be considered the separate property of Frank Smith." The reason that this never happens in the real world is that usually divorce is not being considered when the injury case is settled and the plaintiff's attorney would have a huge conflict of interest at the mediation if such a stipulation is proposed. Each spouse would need his and her own lawyer to make such a stipulation and that is just not what happens in the personal injury world, unless the divorce is already occurring when the injury claim is settled. As a practical matter, the non-injured spouse would be unlikely to sign such a stipulation if properly advised because it would mean he or she would get less in the divorce property division.

2. The spouse proves that there were no damages suffered that would be community damages. For example, the spouse who sues for intentional infliction of mental distress could show that he did not seek nor did he suffer any damages for lost wages or medical expenses.

3. Recovery is made after a jury trial <u>if the defendant pays what the jury awarded.</u> If a case went to trial and a jury awarded specific amounts for each element of damages and if the defendant does not appeal or loses on appeal and pays according to the jury verdict, there would be specific proof of each element of damages. Presumably, the pre-judgment interest and post-judgment interest would be calculated on each element of damages and so apportioned between the spouses. **However, if there is a jury verdict and an appeal and then the parties settle for an amount less than what the jury awarded, the parties are back in the situation described above, where it is a lump sum settlement and no specific amounts are assigned to each element of damage and it would be considered all community property.**

Tips For The Divorce Attorneys

The attorneys representing the spouses in a divorce involving the proceeds of an injury settlement should obtain the following documents, either from the other spouse, the plaintiff's attorney who handled the injury claim or even the insurance company:

1. The plaintiff's "live" pleading at the time of settlement if suit had been filed. This will show the elements of damages that were being claimed.

2. The complete settlement agreement and the release, which may be in one agreement or may be in a mediated settlement agreement or Rule 11 agreement and a release.

3. The settlement check from the insurance company.

4. The plaintiffs' attorney's explanation of the settlement disbursement, which shows the total payment from the insurance company and the deductions for fees, expenses and loans and what was paid to the clients.

5. A copy of the check paid from the plaintiff's attorney to the client(s).

6. A copy of the plaintiff's attorney's settlement demand letter to the insurance company or mediation memo which outlines the damages being sought,

7. If applicable, the bank statements and deposit slips showing the deposit of the settlement proceeds and the tracing of the funds up until the time of divorce.

Even if the entire settlement is considered to be community property, the divorce lawyer for the injured spouse should argue that he should be awarded a disproportionate share of the community property because he was the one who was physically injured and who faces future disability. One of the "just and right" factors a court may consider in dividing community property is the health of the spouses. *Murff v. Murff*, 615 S.W.2d 696, 699 (Tex. 1981). However, if the entire original settlement was community property, there is no need to try and trace the funds from the date of settlement to the time of divorce.