FOLLOW THE MONEY

Exploring the development of tracing commingled funds in divorce cases.

BY RICHARD R. ORSINGER

Separate property cannot be divided in a Texas divorce.[1] For this reason, proving what qualifies as separate can be important. Where separate property changes in form during marriage, its separate identity is not lost if it can be "traced" through its mutations. Early Texas Supreme Court decisions shaped the basic principles of tracing separate property, but where separate and community funds were commingled in an account with many deposits and withdrawals, tracing was considered to be impossible. This changed in 1976—due to the ingenuity of one family lawyer.

Under Spanish law, everything purchased by a spouse during marriage "fell into the common stock of gains."[2] However, tracing was recognized for payments received on separate property debt. The Texas Supreme Court adopted this exception in 1849.[3] Spanish law also held that property purchased with a wife's separate property cash remained separate.[4] Two years later, the Texas Supreme Court adopted this rule and extended it to both spouses.[5] The justices observed that cash purchases would be harder to prove to be separate than bartered exchanges[6] but said the "very cogent" presumption that all property owned by spouses during marriage is community property can be repelled by "clear and conclusive proof."[7]

In 1854, the Supreme Court held that a promissory note, received by a wife for the sale of her separate property, was also her separate property,[8] stating: "to maintain the character of separate property, it is not necessary that the property … should be preserved in specie, or in kind. It may undergo mutations and changes, and still remain separate property; and so long as it can be clearly and indisputably traced and identified, its distinctive character will remain."[9] The Supreme Court reaffirmed this rule of mutation in 1859.[10]

Texas' highest civil court encountered the issue of commingled funds in 1888 in *Continental Nat. Bank of N.Y. v. Weems*,[11] where a New York bank presented commercial paper from a Texas bank as payment, and the Texas bank set funds aside in its vault to cover the claim. The Texas bank then became insolvent. In ruling that the New York bank's claim had priority over the claims of other creditors, the Supreme Court invoked the rule of trust law that, where a trustee commingles trust funds with other funds, the commingled mass belongs to the beneficiary if the trust funds can be identified.[12] If the mixed funds' total never dropped below the amount held in trust, it didn't matter if the specific dollars held had been "paid out by the bank to its utmost farthing," since "every dollar so expended left its representative and exact equivalent in the vault."[13]

The court noted prior Texas cases allowing a wife to trace her separate funds in the hands of her husband, saying that its ruling "results from an application of the doctrine of constructive trusts to the separate property of the wife,"[14] adding that "where the trustee mingles the trust money with his own, whenever he pays out (leaving enough to cover the trust fund) he is presumed to pay out his own money."[15]

In the 1951 state appellate court case *Farrow v. Farrow*,[16] a husband deposited $3,000 of separate property funds into an account whose balance never dropped below that amount. The appellate court affirmed a finding of separate property, saying that "[o]ne dollar has the same value as another and under the law there can be no commingling by the mixing of dollars when the number owned by each claimant is known."[17]

In *Sibley v. Sibley* in 1955,[18] separate property funds of a wife and husband were commingled in a joint account with community funds. There were numerous deposits, funds were withdrawn to pay living expenses, and then a check was written to purchase a farm.[19] The Texas appellate court affirmed the trial court's finding that the wife's separate property flowed into the farm, noting that "where a trustee draws checks on a fund in which trust funds are mingled with those of the trustee, the trustee is presumed to have checked out his own money first," and then finding that:

> The community moneys in joint bank account of the parties are therefore presumed to have been drawn out first, before the separate moneys are withdrawn ... and since there were sufficient funds in the bank, at all times material here, to cover [the wife's] separate estate balance at the time of the divorce, such balance will be presumed to be her separate funds.[20]

The case was later cited in the 1976 case of *Horlock v. Horlock*,[21] where the appellate court said, "*Sibley* stands for the proposition that where a bank account contains both community and separate monies, it is presumed that community monies are drawn out first."[22]

That same year in a Laredo divorce case involving commingled separate property gas royalties, San Antonio family law attorney James D. Stewart took from *Farrow* the idea that "a dollar is a dollar," and from *Sibley* "the community-out-first rule," and fashioned what he called tracing sheets, which were paper spreadsheets listing the date and amount of every deposit in and withdrawal from each of the parties' bank accounts in chronological order, with source or use identified. In these sheets Stewart kept running balances of separate and community funds in each account, with deposits of royalty payments added to the separate property balance and other deposits to the community. Using the "community-out-first rule," withdrawals were taken from community funds until they were exhausted and then from separate funds until more community property funds were deposited, after which withdrawals would revert to the community funds until they were depleted.

This tracing effort predated the use of personal computers and electronic spreadsheets so it took months of writing, calculating, and erasing to accomplish. At trial, the client's accountant sponsored the tracing sheets as a summary of voluminous records, but the exhibits were excluded. Stewart tried different approaches to admissions, but each time was rebuffed until the trial judge[23] said, "Mr. Stewart, if you offer that exhibit into evidence one more time, the court is going to hold you in contempt." Later in the trial, Stewart offered the tracing sheets through the husband as his business records. With that predicate, the trial judge said, "Mr. Stewart, I see that we will never finish this trial unless I admit your exhibit, so your exhibit is admitted." In his ultimate decision, the trial judge found a substantial portion of the estate to be the husband's separate property, meaning that the tracing sheets had done their job of tracing commingled funds.

Stewart then undertook to build a consensus regarding his tracing sheets. He attached sample-tracing sheets to his CLE articles and had his friends do the same, and over time, his methodology gained general acceptance. The use of the sheets based on the community-out-first rule withstood a concerted attack in the 1990 case *Welder v. Welder*,[24] where the appellate court held the tracing sheets admissible as summaries of voluminous records. Today, the use of tracing sheets based on the community-out-first rule is commonplace.

This application of the community-out-first rule has not been without criticism. The late Joseph W. McKnight, a professor at Southern Methodist University Dedman School of Law—in many respects the father of modern Texas family law—condemned the whole line of community-out-first rule decisions as "the inequitable bastard-descendants of *Sibley*" and criticized one appellate decision for its "simplistic reliance on the bastard line of cases, which are contrary to all principles of equity."[25]

Nevertheless, tracing commingled separate and community property now securely rests on the two principles—"a dollar is a dollar" and the community-out-first rule—first employed by Stewart back in 1976. **TBJ**

NOTES

1. *Eggemeyer v. Eggemeyer,* 554 S.W.2d 137, 139-140 (Tex. 1977). Separate property is property owned or claimed before marriage, acquired during marriage by gift, devise, or descent, or set aside as a spouse's separate property by premarital or post-marital agree. Tex. Const. art. XVI, §15; Tex. Fam. Code § 3.001, 4.003, 4.102, & 4.103.
2. *McIntyre v. Chappell,* 4 Tex. 187, 198-99 (Tex. 1849) (Wheeler, J.).
3. *Id.* at 198-99.
4. *Love v. Robertson*, 7 Tex. 6, *11 (Tex. 1851) (Wheeler, J.).
5. *Id.* at *11.
6. *Id.* at *11.
7. *Id.* at *11.
8. *Rose v. Houston*, 11 Tex. 324, 326 (Tex. 1854) (Wheeler, J.).
9. *Id.*
10. *DeBlane v. Hugh Lynch & Co.*, 23 Tex. 25 (Tex. 1859).
11. 69 Tex. 85 (Tex. 1888).
12. *Id.* at 497-98.
13. *Id.* at 498.
14. *Id.* at 499.
15. *Id.* at 500.
16. 238 S.W.2d 255 (Tex. Civ. App.—Austin 1951, no writ).
17. *Id.* at 257.
18. 286 S.W.2d 657 (Tex. Civ. App.—Dallas 1955, writ dism'd).
19. *Id.* at 658-59.
20. *Id.* at 659.
21. 533 S.W.2d 52 (Tex. Civ. App.—Houston [14th Dist.] 1976, writ dism'd).
22. *Id.* at 58.
23. Retired Bexar County District Judge Walter Lochridge.
24. 794 S.W.2d 420 (Tex. App.—Corpus Christi 1990, no writ).
25. Joseph W. McKnight, *Family Law: Husband and Wife*, 55 SMU L. Rev. 1035, 1048 n. 87 (2002).

RICHARD R. ORSINGER,

a lawyer in San Antonio, has written several papers on the history of Texas law for the Texas Supreme Court Historical Society and numerous papers on family law and marital property, which can be found at orsinger.com/articles.shtml.