Business Organization

California Bar Examination

Essay Questions and Selected Answers

February 2002

Question 3

Acme Corporation was a publicly traded corporation that operated shopping malls. Because of an economic slowdown, many of Acme's malls contained unrented commercial space. Additionally, the existence of surplus retail space located near many of Acme's malls prevented Acme from raising rents despite increasing costs incurred by Acme.

In June 2001, Sally, president and sole owner of Bigco, approached Paul, Acme's president. She proposed a cash-out merger, in which Bigco would purchase for cash all shares of Acme, and Acme would merge into Bigco. Sally offered $100 for each outstanding share of Acme's stock even though Acme's stock was then currently trading at $50 per share and historically had never traded higher than $60 per share.

Paul, concerned about Acme's future, decided in good faith to pursue the merger. In July 2001, before discussing the deal with anyone, Paul telephoned his broker and purchased 5000 shares of Acme at $50 per share. Paul then presented the proposed merger to Acme's board of directors and urged them to approve it. The board met, discussed the difference between the current market share price and the offered price, and, without commissioning a corporate valuation study, voted to submit the proposed deal to a shareholder vote. The shareholders overwhelmingly approved the deal because of the immediate profit they would realize on their shares. Based solely on shareholder approval, the board unanimously approved the merger, and all shareholders received cash for their shares.

In December 2001, shortly after completing the merger, Bigco closed most of the Acme malls and sold the properties at a substantial profit to a developer who intended to develop it for light industrial use.

1. Did Paul violate any federal securities laws? Discuss.

2. Did Paul breach any duties to Acme and/or its shareholders? Discuss.

3. Did the board breach any duties to Acme and/or its shareholders? Discuss.

ANSWER A TO QUESTION 3

PAUL'S VIOLATION OF FEDERAL SECURITIES LAW

The issue here is whether Paul violated any federal securities laws by purchasing 5000 shares of Acme stock prior to the merger with Bigco. The two main federal securities laws that Paul could be liable under are Rule 10b-5, which prohibits insider trading, and Section 16(b), which imposes strict liability on officers, directors, and 10% shareholders for trading the stock of their company within 6 months of each other. Each will be discussed below:

Rule 10b-5

The issue is whether Paul violated rule 10b-5 of the SEC. Rule 10b-5 prevents insider trading by making it illegal for one who owes a fiduciary duty to a corporation and possesses "inside information" to use an instrumentality of interstate commerce to buy or sell the corporation's stock. Additionally, the rule contains a scienter requirement. The "insider" must either disclose the information or abstain from trading.

A person who owes a fiduciary duty is one who is an officer, director, attorney, employee, etc. who owes some duty (duty of care, loyalty, confidentiality, etc.) to the corporation. As the president of Acme, Paul is an officer and is clearly within the class of persons owing Acme a fiduciary duty.

Inside information is that information that a reasonable trader would want to know before buying or selling the corporation's stock. Here, the information was that Bigco had proposed a merger and buyout of Acme's stock at twice its current selling price and $40 higher than it had ever traded before. This information would be crucial to any person who was trading Acme's stock.

Using an instrumentality of interstate commerce is easily satisfied. Here, Paul used the telephone to place the order to his broker. The telephone lines cross state lines and are used to conduct business across state lines. Therefore, this requirement is satisfied as well.

Paul did purchase 5000 shares of Acme's stock. And, he did so with improper intentions. This is what is required in "scienter" -- it is knowledge that what one is doing is wrong. In short, Rule 10b-5 requires that the insider to something "slimy" and repugnant to an ordinary person. Purchasing 5000 shares of his company's stock on the basis of inside information is just what Rule 10b-5 was enacted to prevent.

The "abstain or disclose" rule is also part of 10b-5. Here Paul did eventually disclose the Bigco offer to the Board of Directors, and then to the shareholders, he traded on the information prior to disclosing. The announcement could have increased the current trading price of Acme, and Paul took advantage of the low price of Acme stock by purchasing before the disclosure.

In short, Paul has violated Rule 10b-5 and will be forced to disgorge his profits to the corporation.

Section 16(b)

The issue here is whether Paul violated Section 16(b). Section 16(b) imposes strict liability on any officer, director, or shareholder owning 10% or more of the outstanding stock from buying and selling or selling and buying stock of the company within 6 months of each transaction. There is no "guilty mind" requirement as in 10b-5 because the idea is that it is simply bad policy and bad for the market to have these persons trading. In order for Section 16(b) to apply, the corporation has to either be publicly traded or be of sufficient size to meet the guidelines. Here, Acme is a publicly traded corporation, and Paul, as president is an officer; therefore, the rule applies.

Here, Paul bought 5000 shares in July of 2001. If he sold those shares within 6 months, he is strictly liable to the corporation. The facts do not indicate when Bigco purchased the shares, but it had to be prior to December of 2001, when Bigco closed the malls. This is 6 months or less from the purchase. Paul therefore is strictly liable for profits.

Profits under 16(b) are tricky -- the calculation is the difference between the lowest price in the six month period and the highest price in the six month period. Paul's profits were at least the same as they would be under 10b-5. However, if the price fluctuated under $50 or sold for more than $100, P would be liable for that additional amount as well.

Conclusion

Paul has violated both Rule 10b-5 and Section 16(b).

PAUL'S BREACHES OF DUTY TO ACME/SHAREHOLDERS

The issue is whether Paul breached any duty to Acme or the shareholders. Paul owes two overarching duties to the corporation and hence the shareholders: the duty of care and the duty of loyalty. Each are discussed below.

Duty of Care

As an officer, Paul owes a duty of care to Acme. Paul must act as a reasonably prudent person would in this situation. He must act in good faith and in what he honestly believes is the corporation's best interest.

Paul, in good faith, decided to pursue the Bigco merger. A reasonably prudent person would most likely do the same thing. A merger would be good for the shareholders because the company was suffering from financial hard times. However, Paul apparently did not do any checking on Bigco's intentions after the merger. Had Paul done some investigating, he might have been able to discover that the reason Bigco was offering so much for the Acme stock was because it had a developer waiting to purchase the property and make a substantial profit.

Business Judgment Rule

Paul will assert that his actions did not violate the duty of care he owes the corporation because he acted under the protection of the business judgment rule. The

business judgment rule provides that when an officer or director acts in a way motivated by a good faith belief that he is acting on behalf of the corporation's best interests and that judgment turns out in hindsight to be wrong, the court will not step in [and] hold the officer or director liable.

However, the corporation or the shareholders will be able to argue that a reasonable person would have made the further inquiries, that the high asking price should have tipped Paul off that something else was happening here. This was a substantially high price for stock here -- Acme had never traded higher than $60/share, and Sally offered $100/share while the market was depressed and Acme was suffering financial hardship. This would have tipped off any reasonable person that something was motivating her.

Therefore, the business judgment rule will probably not protect Paul's decision in the end. While pursuing the merger might have been a wise choice, the failure to inquire into the basis of the merger was a violation of the duty of care.

Duty of Loyalty

As an officer, Paul owes a duty of loyalty to the corporation as well. This means that Paul must put the corporate interest ahead of his own, or those close to him, at all times. There are many ways to violate the duty of loyalty; of particular relevance here is the duty not to engage in interested transactions.

Normally, an interested transaction is one where the officer has an interest such as an ownership in another corporation that this corporation is considering doing business with. Here, however, the interest came in the $250,000 Paul spent on Acme's stock before he went to the Board with the merger proposal. A quarter of a million dollars -- there was no way that Paul would be able to act in an impartial manner in this transaction. By purchasing the stock before he even went to the meeting and informed the board of the merger proposal, he had indicated that he had decided it was going to happen. Otherwise, he risked losing that money.

As such, Paul violated his duty of loyalty to the corporation.

Conclusion

Paul has violated both the duty of loyalty and the duty of care he owed to the corporation.

THE BOARD'S BREACHES OF DUTY TO ACME/SHAREHOLDERS

The issue is whether the Board breached any duty to Acme or the Shareholders. Directors owe two overarching duties to the corporation and hence the shareholders: the duty of care and the duty of loyalty. Each are discussed below.

Duty of Care

The board of directors owes the same duty of care that Paul, as an officer, owes. The Board will, like Paul, argue that the Business Judgment Rule protects their decision to take the merger to the shareholders. However, like Paul, the argument will fail.

One of the fundamentals of the duty of care is that the directors need to investigate. Here, all the directors saw was dollar signs. They did not take the time to get a corporate valuation study, which in all likelihood would have revealed the developer that Bigco was dealing with, or some other similar venture. Directors are allowed to base decisions on the recommendations of employees or other people who have relevant information. However, there has to be some basis for this reliance. Here, the directors only relied on Paul's recommendation. Paul had done nothing to indicate that he had substantially investigated the deal. All the board based its decision on was the price. While price is important, it is not the only concern of the board. The board should have investigated further.

Therefore, the board breached its duty of care to the corporation and is not protected by the business judgment rule.

Duty of Loyalty

The board owes the same duty of loyalty that Paul, as an officer, owes. There is no evidence here of any interest on the part of the directors. If the directors were also large shareholders in Acme, that might provide the basis for the breach of the duty of loyalty, but absent such or similar evidence, there is no indication that the board breached any duty of loyalty to the corporation.

Conclusion

The board has violated its duty of care owed to Acme, but no facts indicate that a suit for violation of the duty of loyalty could be maintained.

POSSIBLE DEFENSES BY PAUL AND THE BOARD

Shareholder Approval

Paul and the board both could attempt to defend any liability based on the fact that the shareholders approved the merger. The merger constituted a fundamental corporate change, and as such, required shareholder approval. Therefore, the board acted properly in submitting it to them. However, the shareholders are permitted to rely on the board's recommendation, as they did here.

Therefore, the shareholder approval will not protect either Paul or the Board.

ANSWER B TO QUESTION 3

1. Did Paul violate any federal securities laws?

Rule 10b-5

Rule 10b-5 is a federal law that makes it illegal for any person to use any means or instrumentality of interstate commerce to engage in a scheme to defraud, make an untrue statement of material fact (or omit a material fact) or engage in any practice that operates a fraud, in connection with the purchase or sale of a security. The elements of a violation of Rule 10b-5 therefore include an instrumentality of interstate commerce, scienter, an act or misstatement and the purchase or sale of a security.

Here, Paul telephoned his broker, which satisfies the element of interstate commerce. The "means or instrumentality" requirement is broadly defined to include anything that affects interstate commerce, and the use of the telephone is included. (Also, the facts state that Acme Corporation is publicly traded. If it is traded on a national exchange, Paul would satisfy this element even without using the telephone.)

Paul purchased 5000 shares of Acme while in possession of insider information, which is insider trading. Paul is an insider of Acme Corporation because, as its president, he is in a position of trust and confidence to the corporation. He knew about the merger proposal when he purchased the shares, even though not even the Board, much less

the public, knew about it. Inside information is material nonpublic information, which includes any information about which there is a substantial likelihood a person would be interested (or that a person would find persuasive) in deciding whether to buy or sell the security. A potential $50 per share profit in a month or two is certainly material.
Because Paul is an insider and he possessed inside information, he had an obligation to either disclose the information or abstain from trading on it. He violated this duty when he purchased the shares without disclosing the offer.

Paul's knowing disregard of his duty to disclose or abstain fulfills the scienter element of a Rule 10b-5 violation. His purchase of the shares is the requisite act and also satisfies the purchase or sale requirement.

Paul has violated Rule 10b-5.

Section 16b

Section 16b makes it illegal for any director, officer or 10% shareholder of a company to profit from the purchase and sale, or sale and purchase of shares of that company's equity securities within a time frame of 6 months; if the company has 500 shareholders and $10,000,000 in assets or is traded on a national exchange.

Here, Paul purchased 5000 shares of Acme stock at $50 per share in June of 2001. Because he was a shareholder of Acme when the merger was approved, he received $100 per share. The merger was completed prior to 2001, so Paul's profit was

sustained within 6 months. Acme Corporation is publicly traded. If it has 500 shareholders and $10M in assets or is traded on a national exchange, Paul has violated Section 16b. His profit of $50 per share times 5000 shares must be disgorged to the company. Therefore, Paul owes Acme (now Bigco) $250,000, assuming someone pursues this claim against him. He will have to defend a claim by any shareholder who held shares of Acme in June 2001 when Paul purchased the 5000 shares, and remained a shareholder through the merger and the suit.

2. Has Paul breached any duties to Acme and/or its shareholders?

As Acme Corporation's President, Paul owes Acme and its shareholders the duties of care and loyalty. He is therefore required to act in good faith as a reasonably prudent person would and in the best interests of Acme and its shareholders.

Paul's decision to pursue the merger was in good faith and supported by his concern about Acme's future. Therefore, this decision did not breach his duties.

However, Paul's purchase of 5000 shares of Acme stock based upon material inside information breached his duty of loyalty. An officer or director may not profit at the expense of the company or its shareholders. Paul purchased his shares from either Acme or another shareholder, so he profited at their expense when he reaped the $50 profit per share associated with the merger.

Paul may also have breached his duty of care when he submitted the merger proposal to the Board and urged them to approve it. Other than Paul's good faith concern about Acme's future, there is nothing in the facts to suggest that Paul did any research regarding the offer or the other possible ways Acme could make a profit. Since the facts indicate that Bigco sold Acme's properties at a substantial profit shortly after the merger, it appears that there were options Paul failed to look into or convey to the Board.

3. Did the Board breach any duties to Acme and/or its shareholders?

As with Paul, the Board as directors have duties of care and loyalty they owe to the corporation. This means that they must act as reasonably prudent persons would, and in good faith, in the best interests of the corporation and its shareholders.

The business judgment rule prevents the directors from being liable for any action taken in good faith that they reasonably believed to be prudent in their business judgment. The directors are also allowed to rely on the recommendations of officers in good faith.

Here, the Board was unaware of Paul's breach of duty when it relied on his recommendation, so the reliance was probably justified. However, a closer question arises regarding the Board's decision to submit the merger proposal to shareholders without commissioning a corporate valuation study or, as with Paul (above), considering alternative sources of profit. If a reasonably prudent person in conducting his or her

own business affairs would have taken such actions then the Board's failure to do so breached their duty of care owed to both the corporation and its shareholders.

As with Paul, the Board likely should have considered other possibilities or commissioning a valuation study. A reasonably prudent person, when offered double what that person previously believed to be the fair value of his or her property, would probably look into whether there was value to the property of which he or she was unaware.

On the other hand, the fact that the shareholders overwhelmingly approved the deal undermines this argument and could be used as evidence that the Board acted prudently.

The Board also breached its duties by failing to vote on the merger proposal until after the shareholders had already approved it. The Board may not shirk its responsibility to make decisions for the corporation and leave the decisions to the shareholders. The shareholders must see the Board's decision in the proposal.

ESSAY QUESTIONS AND SELECTED ANSWERS

JULY 2003 CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the July 2003 California Bar Examination and two selected answers to each question.

The answers received good grades and were written by applicants who passed the examination. The answers were prepared by their authors, and were transcribed as submitted, except that minor corrections in spelling and punctuation were made for ease in reading. The answers are reproduced here with the consent of their authors and may not be reprinted.

Question 1

Corp is a publicly held corporation whose stock is registered under Section 12 of the Securities Exchange Act of 1934. The following sequence of events occurred in 2003:

January 2: Corp publicly announced that it expected a 25% revenue increase this year.

March 1: A Corp director ("Director") sold 1,000 Corp shares for $25 each.

June 15: Corp learned that, because of unforeseen expenses, its revenues would decrease by 50% this year, contrary to its January 2 announcement.

June 16: A Corp officer ("Officer") consulted his lawyer ("Lawyer") for personal tax advice. Officer mentioned, among other things, the probable devaluation of his Corp stock.

June 17: Lawyer telephoned his stockbroker and bought a put option for $1,000 from OptionCo. The put option entitled Lawyer to require OptionCo to buy 1,000 Corp shares from Lawyer for $20 per share.

June 18: Corp publicly announced that its revenues would decrease by 50% this year. Its stock price fell from $30 to $5 per share.

June 19: Lawyer bought 1,000 Corp shares at $5 per share and required OptionCo to buy the shares for $20,000 pursuant to the put option.

July 1: Director bought 1,000 Corp shares for $5 per share.

1. In each of the foregoing events, which of the actions by Director, Officer, and Lawyer constituted a violation of federal securities laws and which did not? Discuss.

2. Did Lawyer violate any rules of professional responsibility? Discuss.

Answer A to Question 1

Publicly Held Corporation

Corp is a publicly held corporation and is thus subject to federal securities laws. The two laws at issue in this question are Rule 10(b)5 and Rule 16(b).

Director Liability for violating Rule 16(b)

Rule 16(b) prohibits a director, officer or 10% shareholder of a publicly traded corporation on a national stock exchange or with assets of over $10,000,000 and 500 shareholders from purchasing and selling or selling and purchasing stock of the corporation in less than 6 months. This is deemed short swing trading. The policy behind prohibiting short swing trading is that short swing trading is against the interests of the corporation.

Corp is entitled to recover the maximum difference between an[y] sale and purchase during this 6 month period.

On these facts, Director sold 1,000 corp shares for $25 each on March 1. Less than 6 months later on July 1, director purchased corp shares for $5 per share.

The corp is entitled to recover $25-$5=$20 multiplied by 1,000 shares or $20,000 dollars from this violation of Rule 16(b).

Officer Not Likely Liable for violating Rule 10(b)(5)

Rule 10(b)(5) prohibits the use of an instrumentality of inter-state commerce in any scheme to defraud, make material misrepresentations or omissions or in any other way use fraud in the purchase or sale of securities. An insider must either disclose inside information or not trade in the securities. An insider may also be liable for tipping information regarding the company for an improper purpose.

On these facts, officer had a fiduciary duty to Corp. That duty included not disclosing private information regarding Corp. Officer violated his fiduciary duty to Corp when he improperly mentioned the probable devaluation of Corp stock on June 16th prior to public disclosure of this information on June 18th.

However, Officer is only liable for a 10(b)(5) violation if he tipped this information to his lawyer for an improper purpose. An improper purpose would be personal gain of Officer either by pecuniary gain or by gifting to Lawyer. It is unclear whether Officer used a telephone to speak with Lawyer or whether he met him in person. Thus, the instrumentality of inter-state commerce requirement may be lacking as well. The facts tell us that Officer was seeking tax advice, then he mentioned the devaluation. There is no other indication of personal gain by Officer resulting from telling Lawyer about the devaluation.

Officer is not likely liable for tipping for an improper purpose and thus did not violation[sic] Rule 10(b)(5).

Lawyer Not Liable under Rule 10(b)(2) but is Liable for Misappropriation

A tippee is only liable if the tippee knew that the tipper was giving them non-public information for an improper purpose. As detailed above, it is unlikely that Officer will be liable for tipping for an improper purpose. Thus, Lawyer is not liable under this section.

Note that if Officer had an improper purpose, it would be easier to find Lawyer satisfied the other tippee requirements because Lawyer should have known that the information from Officer was private information regarding Corp. Lawyer knew that Officer had a duty not to disclose such information. Nonetheless, Lawyer traded on such information.

Misappropriation Liability

Some courts would find that Lawyer is liable for misappropriation of non-public (insider) information in the purchase or sale of securities.

Lawyer used the insider information to purchase a put option from Option Co[.] prior to the public announcement on June 18th. This bound Option Co. to purchase 1,000 Corp shares from Lawyer at $20 per share. Lawyer then purchased Corp shares at the discounted rate of $5 per share after the public announcement (June 19th). Lawyer profited at $15 per share multiplied by 1,000 shares=$15,000. This $15,000 was ill gotten gain from misappropriating non-public information about Corp's revenue decline.

2. Lawyer's Violations of Rules of Professional Responsibility

Lawyer violated the duty of loyalty to Officer, the duty of confidentiality, the duty of care, and engaged in deceitful, dishonest/fraudulent conduct that both negatively reflects on Lawyer's ability to practice law and that harms the dignity of the profession.

Duty of Care

A lawyer has a duty to act as a reasonable lawyer of ordinary skill, judgment and preparation. Here, Lawyer's actions were patently unreasonable. Use of a client's corporation information fell below the standard of care of a reasonable attorney.

Duty of Loyalty

A lawyer has a duty to act in the best interests of the client and not to personally benefit at the client's expense. This includes a duty not to self-deal. Lawyer took advantage of a breach of Officer's fiduciary duty to keep Corp's information private for personal gain. Lawyer benefitted from the insider trading. Lawyer may also have created professional and legal liability for his client by using this information. Lawyer breached the duty of loyalty to

Officer.

Duty of Confidentiality/Confidential Communications

A lawyer has a duty to keep all communications from his client related to his representation of the client confidential. Courts interpret "related to the representation" quite broadly. Officer consulted Lawyer about personal tax advice. The equity value of Corp may have been related to this representation. This includes using any of such confidential communication. As discussed above, Lawyer used such confidential communication to do insider trading. Lawyer violated his duty to keep Officer's information confidential.

Attorney-Client Privilege

The attorney-client privilege is a more narrow evidentiary exception that prevents a court from obtaining information told to a lawyer by his client related to the litigation at issue. Here, there is no pending litigation discussed. Under the ABA rules, an attorney may disclose confidential communication to prevent a future crime involving death or serious bodily injury. California does not have a clear exception for death. On these facts, Officer's statement regarding Corp's shares would not likely fall under the attorney-client privilege.

Duty Not to Engage in Deceit, Fraud in Personal Dealings

A lawyer has a duty not to use deceit or fraud in private dealings. Here, the facts show that Lawyer deceitfully misappropriated insider information and used fraud to obtain a lucrative option from Option Co. Lawyer should be subject to discipline for these private acts as well.

Duty to Maintain Dignity of Profession

A lawyer also has a duty to maintain the dignity of the profession. For all of the reasons mentioned above, Lawyer violated this duty. A lawyer who acts with deceit and fraud in his private dealings stemming from improperly used information from a client lowers the reputation of the entire profession.

Answer B to Question 1

Director's Actions

The Director ("D") may be liable for violations of federal securities law based on his sale and purchase of 1,000 Corp stocks during 2003. The Corp stock is an equity security, and therefore, is subject to federal securities laws. There are two bases for D's liability under federal securities law: violation of Rule 10B-5 and violation of Section 16B. Please note that D may also be liable for common law violations of his duty of loyalty as a corporate director, but that issue is not to be addressed here.

Rule 10B-5 Liability

Rule 10B-5 makes it illegal to use deceit or any fra[u]dulent scheme in connection with the purchase or sale of a security. Here, the issue is whether D used deceit and/or fraud when he sold Corp stock on March 1, and when he bought it at a lower price on July 1.

Rule 10B-5 Elements

The elements of Rule 10B-5 are as follows: (1) use of the instrumentalities of interstate commerce (which gives the federal government jurisdiction over the transaction); (2) a fraudulent scheme or device, which includes (a) misrepresentation of a material fact and (b) insider trading; that is, trading on the basis of material inside information; (3) in connection with the purchase or sale of a security; (4) with scienter, which must be at least recklessness; and (5) reliance by the person on the other side of the transaction, which is presumed in cases of misrepresentation and insider trading. Any person may be liable for insider trading, and plaintiffs include both private persons on the other side of the transaction and the SEC. In addition, "materiality" means that which a reasonable investor would want to know in making his investment decision.

With these elements in mind, I shall assess D's liability under Rule 10B-5.

March 1 Sale

D sold 1,000 Corp shares for $25 on March 1. This transaction will fall under the jurisdiction if D used the instrumentalities of interstate commerce, which includes the telephone, US mails or internet. Here, I will assume that he did so. Note that if D had not used interstate commerce, he could still be liable under state securities laws. In addition, since D actually sold his shares, the transaction is "in connection with a purchase or sale" and, thus, D will be liable if he used fraud or deceit in this sale with necessary scienter.

Misrepresentation of a Material Fact. The main issue is whether the Corp's public announcement that it expected a 25% increase in 2003 constituted a misrepresentation of a material fact for which D may be liable. Surely, an investor would consider it material that the revenue increase would not happen, and would instead decline.

If the corporation recklessly made that announcement in order to pump up its stock price, then D, as a corporate director, would be liable. However, the facts indicate that D sold his stock on March 1, many months before the Corp learned that its revenues would actually decrease by 50% during 2003. In addition, the facts also indicate that the revenue decrease was due to "unforseen expenses". If anything, Corp was negligent in making a bold revenue prediction that was reversed six months later. Therefore, Corp, and hence, D, did not have the necessary scienter to be liable under Rule 10B-5.

Insider Trading. For D to be liable for insider trading, he would have to had traded on material inside information. Since D is a corporate director, he is considered an "insider". Therefore, he may not trade on material inside information. The critical issue is whether D possessed any material inside information when he sold his shares on March 1. If D, in fact, knew on March 1 that Corp would not have a 25% revenue increase, and that revenues would drastically decline, then he may not trade based on that information.

Again, the facts indicate that D sold his shares 3 ½ months before the Corp learned that it would suffer a serious revenue decline, and, thus, probably did not trade on the basis of inside information. However, if he did suspect that the Corp would not reach its revenue target of 25% in his capacity as a corporate insider, then he would be liable under Rule 10B-5.

July 1 Purchase

On July 1, D purchased 1,000 Corp shares for $5. Since the revenue decrease of 50% had been publicly and accurately disclosed a few weeks earlier, D is not liable under Rule 10B-5.

Rule 10B-5 Conclusion

Because the revenue decline was due [to] "unforseen expenses", D probably did not have material inside information, nor possess the necessary scienter to be found liable under Rule 10B-5. However, if the court did find him liable, he would have to disgorge his profits made or losses averted.

Section 16B

D may be liable under Section 16B of the '34 Act, which holds "insiders": directors, officers and 10% shareholders, strictly liable, if they make a "profit" on the purchase and sale of their corporation's stock within a 6 month period. Section 16B applies to public companies, that is, ones that are traded on a public exchange and/or meet the number of stockholders/asset test. Here, Corp is a public company, registered under Section 12 of the '34 Act, and thus, Section 16B applies to D's actions.

March 1 Sale D was an "insider" when he sold his 1,000 shares of Corp stock for $25/share on March 1, and, thus, must comply with Section 16B. The facts do not indicate that D

bought or sold any Corp shares before this date, so I will focus on the subsequent transaction. If D bought shares within 6 months following this sale for a lower price, then he is strictly liable under Rule 16B.

July 1 Purchase On July 1, 4 months following his sale of Corp stock, D purchased 1,000 shares for $5 per share. Since this occurred within 6 months of his sale, D is strictly liable and must disgorge his "profit." Here, D's profit is calculated by the difference between the sale price and purchase price multiplied by the number of shares, which totals $20,000 (1,000*(25-5)).

Officer Liability

The Officer's ("O") only action was consulting his Lawyer ("L") for personal tax advice on June 16, and mentioning that the value of Corp stock would probably go down, since the Corp had just learned that its revenues would decrease the day before.

Rule 10B-5 - Tipping

The elements of Rule 10B-5 are discussed above. As indicated, O did not purchase or sell any securities. Instead, the only basis for his liability would be "tipping". A corporate insider is liable for "tipping" if he has a fiduciary relationship with the corporation and discloses material insider information, at least recklessly, to a "tippee", who trades on the basis of that information. Here, O would be the "tipper" and Lawyer would be the "tippee." A tipper can be liable even if he discloses only to make a gift to the tippee or to enhance his reputation. A tippee will not be liable unless the tipper is first found liable.

O did disclose material insider information to Lawyer, but it does not appear that he did so recklessly, that he intended to make a gift to Lawyer, or wanted to enhance his reputation. Instead, O consulted L for personal tax reasons. As a client, O had every reason to expect that L would keep this information confidential. If, however, O disclosed this information to L to make a gift, use it to pay for legal services, or to enhance his reputation; or if he was reckless in disclosing this info (by shouting it in a public place), he would be liable. However, the facts indicate that O was careful and confidential in disclosing this info.

Therefore, since O was not reckless in disclosing the inside information to L, and [sic] therefore, is not liable under Rule 10B-5.

Section 16B

Although O is an "insider" of a "public company" for Section 16B purchases, since O did not purchase or sell any securities, he has no liability here.

Lawyer Liability

Unbeknownst to O, L traded on the basis of the material inside information about Corp's

unexpected revenue decline that had not been made public as of June 17. On June 17, L bought a "put" option that entitled him to sell Corp shares for $20 per share. He presumably did so fraudulently in order to personally benefit from the inside information. The issue, is however, whether he is liable under Rule 10B-5 or Section 16B.

Rule 10B-5 L's liability would be based on his status as "tippee", since the facts do not indicate that he is an insider of Corp. As discussed above, a tippee is not liable if the tipper is not liable. Since O was not liable as a tipper, L is not prevented from trading on the basis of inside information.

Misappropriation theory. The Supreme Court had found non-insiders liable under a misappropriation theory, where the person uses and trades on inside information that he knows or should know is inside info. Here, L clearly knew that it was inside information since Corp did not publicly disclose its revised revenue forecast until June 18. Therefore, he could be found liable for the misappropriation theory, and be subject to sanctions by the SEC. He would have to disgorge his profits of $15,000 from the put option, which he made on June 19, when he purchased shares for $5,000 in toto and sold them for $20,000.

The misappropriation theory does not apply to individual actions under rule 10B-5.

2. L's Professional Responsibility

L violated several rules of professional responsibility when he traded on the inside information, including the duty of confidentiality, duty of loyalty, duty of fairness and duty to uphold the law.

Duty of confidentiality

A lawyer may not use or reveal anything learned in the course of representing his client without the client's consent. Here, O was L's client, who revealed confidential information to L about the possible devaluation of Corp stock. O did not consent for L to use this information or reveal it to anyone. Although it does not appear that L revealed this information, he certainly used it and therefore, violated the duty of confidentiality. He should not have traded on this information.

Duty of loyalty

A lawyer also owes a duty of loyalty to his client, and may not let personal interests, or the 3rd party or other client interfere with his representation of his client. Here, there is a conflict of interest between O and L. L may not use O's confidential information for his own benefit, which L did so when he purchased the put option.

Duty of Fairness/Candor

A lawyer also owes a duty of fairness and candor to the public and 3rd parties. Here, L

violated that duty by "misappropriating" the inside information and trading on it to his own advantage. By using this info, he acted unfairly to OptionCo, forcing it into a bad deal.

Duty to Uphold the Law

A lawyer also has a duty to uphold the law. Here, L violated the laws of securities trading and committed several breaches of his ethical duties when he used inside information. If he were in California, he would be required to "self-report" this fraudulent activity.

ESSAY QUESTIONS AND SELECTED ANSWERS

FEBRUARY 2005 CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the February 2005 California Bar Examination and two selected answers to each question.

The answers received good grades and were written by applicants who passed the examination. The answers were prepared by their authors, and were transcribed as submitted, except that minor corrections in spelling and punctuation were made for ease in reading. The answers are reproduced here with the consent of their authors and may not be reprinted.

Question 3

Molly and Ruth were partners in the operation of a dry cleaning store. Recent government environmental regulations relating to dangers posed by dry cleaning fluids increased their exposure to liability and caused a decline in their business. Molly and Ruth decided to convert their partnership into Dryco, Inc. ("Dryco"), a corporation, to limit their potential personal liability.

Molly and Ruth each contributed $20,000 in cash to Dryco. In return, each received a $15,000 promissory note from Dryco and 5,000 shares of stock with a value of $1 per share.

Prior to incorporation, Molly entered into a contract on behalf of Dryco with Equipment Company ("EC") for the unsecured credit purchase of an environmentally safe dryer for $100,000. EC was aware that Dryco had not yet been formed. EC delivered the dryer one week after the incorporation, and Dryco used it thereafter and made monthly installment payments.

Dryco had been incorporated in compliance with all statutory requirements, and Molly and Ruth observed all corporate formalities during the period of Dryco's existence. One year after incorporation, however, Dryco became insolvent and dissolved. At the time of the dissolution, Dryco's assets were valued at $50,000. Its debts totaled $120,000, consisting of the two $15,000 notes held by Molly and Ruth and a $90,000 balance due EC for the dryer.

1. As among EC, Molly, and Ruth, how should Dryco's $50,000 in assets be distributed? Discuss.

2. On what theory or theories, if any, can Molly and/or Ruth be held liable for the balance owed to EC? Discuss.

Answer A to Question 3

1. Distribution of Dryco's $50,000 in Assets

Valid De Jure Corporation

A corporation is conclusively formed when the articles of incorporation are filed with the state. Here, the facts indicate that Dryco had been incorporated in compliance with all statutory compliances. Therefore, Dryco will be treated as a de jure corporation.

The Equipment Company Contract (EC)

Whether EC will have a claim to Dryco's assets on dissolution depends on whether EC's pre[-]incorporation contract with Molly as a promoter was adopted by Dryco.

A corporation is not liable for pre-incorporation contracts unless the corporation adopts the contract. Since Dryco did not exist at the time the contract was made, it can have liability unless: i) the corporation expressly adopts the contract (i[.]e[.,] through board resolutions or ii) the corporation accepts or retains benefits from the contract and therefore impliedly adopts the contract.

On these facts, Dryco accepted the dryer, used it, and made monthly payments on it. Even though EC was aware that Dryco had not yet been formed, Molly entered the contract on Dryco's behalf. Further the dryer was delivered after incorporation. EC will argue that Dryco's acceptance and use of the dryer constitutes implied adoption, and will likely prevail.

Therefore, EC has a valued unsecured claim against Dryco's assets.

Promissory Note

Promissory Notes are debt securities of a corporation. The holders of these notes have a creditor/debtor relationship with the corporation, and are on equal grounds with other unsecured creditors of the corporation.

Shareholders' Claims

Shareholders own an equity interest in a corporation. Shareholders are not entitled to distribution of a dissolved corporation's assets until all debts of the corporation have been satisfied.

Distribution

EC and Molly and Ruth stand on equal footing as unsecured creditors. As

shareholders, Molly and Ruth will receive no part of the $50K, as explained above.

As between unsecured creditors, however, there is a possibility that Molly/Ruth's claim will be subordinated by a court to EC's claim, based on corporate veil piercing principals [sic] due to inadequate capitalization at the outset of the corporation.

Piercing the Corporate Veil

A corporation is a separate legal entity designed to insulate its officers, directors, and shareholders from personal liability. However, the corporate form will be ignored in some circumstances, including when i) the corporation is acting as the alter ego of the shareholders or ii) when there was inadequate capitalization of the corporation at the outset.

Inadequate capitalization is determined by looking at if the corporation had adequate funds to meet its prospective liabilities. The time between incorporation and dissolution is also considered.

Here, Dryco was funded with $40,000, and dissolved within one year. The short time in existence may be an indication that the corporation was not adequately funded. However, it is unclear from these facts what caused Dryco's dissolution. If Molly/Ruth were aware of increasing environmental costs and liability, $40,000 may not have been sufficient. If this is so the corporate veil will be pierced. (Desire to shield from personal liability from environmental regulation is not enough to pierce the veil in and of itself.)

When shareholders use the corporation['s assets as their own or otherwise ignore corporate formalities, the corporate form may be ignored to hold the SHs personally liable for the corp's debts[.] Here, there is no indication that Ruth/Mary used Dryco's assets as their own, and they did observe all corporate formalities. Therefore, the veil will not be pierced on this theory.

Since the veil can be pierced due to inadequate capitalization, however, Ruth/Mary's claim on the unsecured notes will be subordinated to EC's claim. EC will receive the entire $50,000.

In the event the claims are not subordinated, EC, Mary and Ruth will equally divide the $50,000.

2. Molly and[/] or Ruth's liability

A corporation is a separate legal entity that insulates its SHs from personal liability. As discussed above, Dryco was a de jure corporation. Unless circumstances exist to pierce the corporate veil, Ruth/Mary will not be liable to EC for the excess debt.

Piercing the Veil

As explained above, the corporate veil may be pierced for inadequate capitalization at the outset. Also as explained above, if the veil is pierced, Ruth/Mary will be liable to EC for the $40,000 of unpaid debt.

Promoter Liability

When a promoter raises capital or enters contracts on behalf of a [sic] unformed corporation, the promoter is personally liable on those contracts. Absent novation, this liability remains even if the corporation has adopted the contract.

Here, Molly entered the contract with EC on behalf of Dryco. Therefore, absent novation, she is personally liable. There is no indication of a novation here, so Molly will be liable for the 40K even though Dryco adopted the K.

Ruth may be liable based on vicarious liability. Ruth and Molly were joint venturers, co-promoters, so EC may try to reach Ruth on this theory, or at minimum, Molly may seek contribution from Ruth. Since Ruth did not sign the contract[,] however, this theory will likely fail.

Answer B to Question 3

3)

1. Distribution of $50,000 of Dryco's assets

Dryco has [sic] $120,000 in debt at the time the corporation became insolvent. This includes the $30,000 in promis[s]ory notes to Molly and Ruth, and the $90,000 still owed to EC, for the environmentally safe dryer. Dr [sic]

Pre-incorporation contract

The issue is whether the debt to Equipment is owed by the corporation. Corporations are only liable for pre-incorporation contracts that they adopt. Here before the corporation was formed, Molly entered into a contract for the the [sic] purchase of the dryer. The facts do not indicate that there was an express adoption of this contract. However the fact that after the corporation was formed, the dryer was delivered to Dryco, used by Dryco, and the monthly installment payments totaling $10,000 were made by Dryco, is sufficient to establish that Dryco impliedly adopted this contract. Furthermore without the Dryer the business might not be able to comply with the governmental regulations imposed on the drycleaning industry. Therefore the dryer is an essential piece of equipment to Dryco and its adoption of the purchase contract entered into by Molly[.]

Inside/Outside Debt

Dryco only has $50,000 in assets, and has $120,000 in debt. Therefore it must be determined which creditors have prio[r]ity for satisfaction. In determining which creditors will be satisfied first the court will generally, in the interest of fairness, subvert inside debt, and allow outside debt to be satisfied first. The reason for this is that the insiders, Molly and Ruth, could have given the $15,000 for stock interests, which would only receive distributions after creditors are satisfied.

Here Molly and Ruth elected to make $15,000 of their $20,000 contribution as a loan. They were trying to insulate themselves further from any potential losses, by only putting at risk the $5,000 for their stock. The court will not allow inside shareholders to try to put their equity investment on an equal level with outside creditors who have no equity interest in the corporation.

Therefore EC should be given priority as an outside creditor and should receive the $50,000 that Dryco has. Molly and Ruth's interest will be subverted to EC's interest and their loan will not be satisfied.

2. Molly and Ruth Personal Liability

After the $50,00 in assets are given to EC, EC is still left with $40,000 that has not been satisfied. EC will thus try to hold Molly and Ruth, as sole shareholders in Dryco[,] personally liable for the remaining debts.

Incorporator liability

Prior to incorporation Molly entered into a contract with EC for the dryer. As a general rule, an incorporator is not relieved of liability of the pre-incorporation contract, until there has been a novation, that is[,] an agreement by all parties to relieve the incorporator of personal liability. Here Molly would have to show that both Dryco and EC to relieved[sic] Molly of personal liability. As discussed above, Dryco impliedly adopted the contract, and thus becomes primarily liable for the contract. However there is no indication that EC relieved Molly of her personal liability, and can be held secondarily liable, because there was no novation.

However, Molly can argue that the contract was entered into "on behalf of Dryco[.]" The corporation by estoppel doctrine holds that a party who knew the contrace[sic] was being entered into on behalf of a corporation is estopped from later claiming that the other party is personally liable. Molly can argue that because EC knew that Dryco had not been incorporated yet, but knew that Molly was entering "on behalf of Dryco" they should be estopped from claiming that Molly is personally liable.

Molly will likely be successful in this claim, and EC will be estopped from claiming that Molly was personally liable, because EC knew that Dryco was not yet incorporated, but still signed a contract "on behalf of Dryco". It would therefore not be equitable for EC to be able to hold Molly personally liable under this theory[.]

Shareholder liability

As a general rule shareholders are not personally liable for the debts of the corporation. The shareholders only put at risk what they invest in the corporation. As discussed above Molly and Ruth each invested $20,000, which will all be treated as equity in Dryco. Therefore under the general rule Molly and Ruth will not be liable for the $40,000 remainder owed to EC.

However where it is necessary to prevent a fundamental unfairness courts may elect to pierce the corporate veil, and hold the shareholders personally liable. Courts generally elect to pierce the corporate where the corporation has attempted to defraud the corporation[']s creditors. Courts are much less likely to pierce the corporate veil for tort creditors than for contract creditors. Here EC was a contract creditor, so EC will have to have a very strong claim to succeed.

Courts will pierce the corporate veil where the shareholders of the corporation fail to follow corporate formalities, or where there [sic] corporation was inadequately capitalized

at the time of formation.

Here the facts state that Molly and Ruth observed all corporate formalities. There are no facts to indicate that there was any com[m]ingling of personal and corporate funds, or that Molly or Ruth treated any of the corporate assets as their own.

EC will try to argue that Dryco was inadequately capitalized at the time of formation, that is[,] that Dryco would be unable to pay debts at the time they came due. Because the EC is a contract creditor they have to make a strong showing. Here Molly and Ruth put in a total of $40,000 cash. Because the inside claim will be subverted to EC claim the full $40,000 should be considered[.] EC wil[l] fail on this claim because the facts indicate that Dryco was able to make the monthly installment payments.

The court will likely find that there was no fundamental unfairness in this transaction, especially because EC was a contract creditor. EC could have protected itself by entering into a separate agreement with Ruth and Molly to agree to personally assume the debt. Because EC did not do this they cannot later claim Molly and Ruth['s] personal assets. Therefore Molly and Ruth will not be personally liable on this claim.

Director liability

As the sole shareholder[s] of Dryco, Molly and Ruth are probably the directors, and as such owe Dryco fiduciary duties of Loyalty and Due Care. Directors can be held personally liable for injuries caused from breaching this duty. However there are no facts suggesting a violation of these duties, such as self[-]dealing or uninformed decision making and [they] should not be held liable for breaching their fiduciary duties.

ESSAY QUESTIONS AND SELECTED ANSWERS

JULY 2005 CALIFORNIA BAR EXAMINATION

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Question 3

Alice is a director and Bob is a director and the President of Sportco, Inc. (SI), a sporting goods company. SI owns several retail stores. Larry, an attorney, has performed legal work for SI for ten years. Recently, Larry and Carole were made directors of SI. SI has a seven-person board of directors.

Prior to becoming a SI director, Carole had entered into a valid written contract with SI to sell a parcel of land to SI for $500,000. SI planned to build a retail store on the parcel. After becoming a director, Carole learned confidentially that her parcel of land would appreciate in value if she held it for a few years because it was located next to a planned mall development. At dinner at Larry's home, Carole told Larry about the planned mall development. Carole asked for, and obtained, Larry's legal opinion about getting out of her contract with SI. Later, based on Larry's suggestions, Carole asked Bob to have SI release her from the contract. She did not explain, nor did Bob inquire about, the reason for her request. Bob then orally released Carole from her contract with SI.

The next regular SI board meeting was attended only by Bob, Alice, and Larry. They passed a resolution to ratify Bob's oral release of Carole from her contract with SI. Larry never disclosed what Carole had told him about the proposed mall development.

Three years later, Carole sold her parcel of land for $850,000 to DevelopCo, which then resold it for $1 million to SI.

1. Was Bob's oral release of Carole from her contract with SI effective? Discuss.

2. Was the resolution passed by Bob, Alice, and Larry to ratify Bob's oral release valid? Discuss.

3. Did Carole breach any fiduciary duty to SI? Discuss.

4. Did Larry commit any ethical violation? Discuss.

Answer A to Question 3

1. Bob's oral release

Bob, a director of SI, entered into an oral agreement to release Carole, another director, from a contract into which she had entered with SI for the sale of land. The question is whether this release was valid.

Statute of Frauds

Contracts for the sale of land must comply with the statute of frauds, and modifications of such contracts must also comply with the statute. Here, the original contract was in writing, but Bob's release was oral. This statute requires a writing signed by the party to be charged. That requirement was not met.

However, courts have held that parties may rescind a contract without complying with the statute. This appears to have been such a rescission. Further, Carole's reliance on the release – by selling the land to another party – was probably sufficient to make the release effective.

Bob's authority to release SI

The release was valid only if executed by someone with authority to bind SI. On these facts, there is no indication that Bob had such authority.

The Board of Directors has the authority to oversee the management of a corporation and approve major business decisions. However, individual directors do not have such authority.

An officer or director may be given actual authority by the articles of incorporation or bylaws to engage in particular duties. Further, a board of directors can delegate certain responsibilities to a committee of directors (which can be a single director). There is no indication here, however, that Bob was delegated authority to enter into land sale transactions. Because these are significant business decisions, it would be inappropriate in any case to delegate them to a single director.

Finally, because making or rescinding land sale contracts is not one of the ordinary duties of a director, Bob had no implied authority as director to release Carole.

In his position as president, however, Bob may have had authority to execute the release. A president of a company may be given specific powers in the articles and bylaws. Again, there is no indication that Bob had such explicit powers. However, a president may also exercise implied or inherent powers necessary to do his job. A president would certainly have the authority to bind the corporation, for example, to ordinary services or employment contracts. Such authority is implied because it is necessary to exercise the

management powers of his job.

In this case, however, the land sale was a major capital investment. Such a major decision was probably not within the province of the president's authority and required Board approval. Therefore, Bob's release was probably not valid.

Board Resolution

The issue here is whether the subsequent ratification of the release was valid.

Quorum

Board actions are valid only if a vote occurs when a quorum of the Board is present. A quorum is normally defined as more than half the directors – in this case, 4 out of 7. Only three directors were present, however.

In its bylaws, a corporation can establish a smaller number for a quorum if it is more than 1/3 of directors. There is not indication, however, that Sportco had varied the normal rule in this case. Therefore, a quorum was not present and the Board's action was invalid.

Interested Director Transaction

As discussed below, this was an interested director transaction because Carole, a director, stood to profit from the sale of the land. Such transactions may be ratified only by a majority of non-interested directors. In this case, then four directors – a majority of the six non-interested directors – would have had to approve this transaction.

Further, to ratify an interested director transaction, the Board would need to know the facts of Carole's transaction in acco[r]dance with their duty of care. Here, Bob, Alice, and Larry did not know Carole's motives.

Because there was no proper ratification of an interested director transaction, the Board's action was invalid.

3. Carole's fiduciary duties

As a director, Carole had a duty of loyalty to the corporation. She had a duty to act in what she reasonably believed to be the corporation's best interest, and not to profit at the corporation's expense.

Here, Carole violated that duty in several ways. First, she used confidential information for her personal gain. This was a violation because she had a duty to keep confidences acquired in the course of her duties and not use them for personal profit.

Second, Carole usurped a corporate opportunity by selling the parcel to DevelopCo. Having learned that the parcel would appreciate in value, Carole had an obligation to let Sportco profit from that opportunity because it was part of Sportco's line of business – that is, finding suitable locations for its sporting good stores. Carole could only have taken advantage of the opportunity herself had she first offered it to Sportco & Sportco had turned it down. Here, however, Sportco was clearly interested in acquiring the land – since, after the land's value became apparent, Sportco brought it.

Finally, Carole's conduct in withholding her true motives from Bob was arguably fraudulent. Because of her fiduciary duty, Carole was obliged to disclose material facts. Carole's knowledge of the proposed mall development would certainly have been material in the Board's decision.

Carole also violated her duty of care as a Board member. She did not act in conducting the corporation's business affairs as a reasonably prudent person would in her own activities. Certainly passing up a valuable business opportunity that Sportco could have profited from was not prudent.

4. Larry's ethical violations

Conflict of Interest

Larry represented SI, not any individual director. By seeking Larry's legal advice on a personal transaction, Carole attempted to use Larry as her personal lawyer. This created at least a potential conflict of interest if Carole's interests should differ from SI's. In this situation, Larry could not represent Carole unless he informed both Carole & SI & both gave consent that an independent lawyer would find reasonable. By advising Carole without seeking such consent, Larry violated his duty of loyalty to each client.

Further, once it became apparent that Carole was seeking to profit at Carole's expense[sic], the conflict was direct. At that point, Larry should have sought Carole's permission to withdraw. Further, as discussed below he probably should have sought to withdraw from the Board as well. In failing to do so, he further violated his duty of loyalty.

Larry's Board Service

No per se rule exists barring a lawyer from serving on his client's board. However, such service may create problems with the duties of confidentiality and loyalty. Here, as a board member, Larry owed fiduciary duties to SI. He was therefore obliged to tell them material information he received relating to Carole's proposed rescission. He violated these by concealing the information. Further, he acted in Carole's best interest, not SI's, by voting to ratify the transaction. Larry should instead have disclosed the existence of a conflict (giving as little information as possible to avoid breaching his duty of confidentiality to Carole for all information arising out of the course of representation). He should then have sought to resign from the Board, and probably from representation of SI as well.

Duty of Loyalty

A lawyer has a duty to represent each client zealously & and put that client's best interests first. Larry did not do so in regard to SI because he did not advise SI how to enforce the contract with Carole – which would have been in SI's best interests.

Duty of Competence

A lawyer has a duty to thoroughly investigate his client's legal issues. Here, Larry failed to learn the facts of SI's transaction with Carole[.]

Duty of Communication

A lawyer must give a client the information necessary to make major decisions relating to the representation. Here, Larry withheld material information re: his consultation with Carole. SI needed this information in order to fully exercise its legal rights.

Because Larry could not fulfill duties to SI w/out breaching his duties of loyalty & confidentiality to Carole, he should have withdrawn from representation of both clients. In addition, he violated his board member fiduciary duties.

Answer B to Question 3

3)

I. Bob's Oral Release of Carole

Bob's Powers as President
A corporate officer, such as president, can only act under proper authority. In his capacity as president, Bob's release of Carole must have arisen under his express, implied, or apparent authority to bind SI.

Express Authority
A corporate officer acts with express authority to bind (unbind) the corporation when the board has formally conferred that authority to him. Here, the board did not not know abou[t] Carole's intention to be released from the contract. It neither held a vote nor a meeting to grant Bob the express authority to "bind" the corporation in this way. Thus Bob lacked express authority to release Carole from her contract with SI.

Implied Authority
A corporate officer has implied authority from the board to bind the corporation to relatively minor obligations that arise in the everyday course of business. Here, however, a sporting goods corporation had bought and was planning to develop a retail store on a parcel of land worth $500,000. SI only owned "several" sporting goods stores, so the addition of another one is a fairly important development. The facts suggest that this was a relatively major business initiative, and so would not fall within the scope of a corporate officer's implied powers. Thus, Bob as acting as president could not have released Carole from her contract under implied authority.

Apparent Authority
A corporate officer has apparent authority to bind (or unbind) the corporation when he is held out to a third party as having such authority, and the third party relies on that authority. Here, apparent authority is not likely, because Carole, as a board member would not precisely [sic] the metes and bounds of Bob's authority as president. She would thus not be able to claim detrimental reliance on Bob's release based on apparent authority.

Bob's Powers as a Director
Carol[e] might also claim that Bob released Carole from her contract based on Bob's position as a director. In order to bind a corporation, board action must consist of a unanimous vote of all members, or a majority of a meeting with quorum. Here, Bob acted unilaterally as a director; there was no meeting and no vote so he, acting as a single director, could not bind the corporation.

II. Validity of the Resolution Passed by Bob, Alice, and Larry

Quorum Rules for Binding Board Action

As mentioned, binding board action can only arise when there is a unanimous vote, or upon a majority of votes at a meeting with quorum. Here, SI's board has seven members, so quorum would constitute four members. Therefore, since quorum was not achieved, no business of the board meeting with only Bob, Alice and Larry could be binding.

Interested Directors

Even if there were additional board members at the meeting, only directors who do not have a personal interest in a transaction can be counted for quorum. Thus, any vote on whether to release Carole from the contract would have to exclude Carole, because she stood to gain considerably if the contract were released based on the appreciation of the land price. It is not clear if Larry should also be excluded. While he was privy to confidential information not shared with the other members of the board, he did not aim to materially gain from cancelling Carole's contract, unless Carole agreed to pay him. If so, then Larry should be excluded from any vote of whether to release Carole from her contract.

III. Carole's Breach of Fiduciary Duties to SI

Carole breached several fiduciary duties to SI.

Breach of Loyalty

Seeking Release from the Land Contract

A director owes a fiduciary duty of loyalty to the corporation, and must always act in the best interests of the corporation without regard for self-interest. Here, Carole sought release from a valid contract with SI for the land for $500,000. Her motivation in doing so was personal gain; after making the contract, she sought release from it because land prices were appreciating and she stood to gain a profit by retaining ownership of the land and selling to another buyer at a higher price. This behavior clearly contravened her duty of loyalty to SI, which was to obtain the land at the lowest possible price[.]

Since she breached her duty, Carole is liable both for any personal gain as well as material loss to the corporate [sic] as a result of her breach. Instead of selling to SI for $500,000, Carole sold the land to DevelopCo for $850,000; the resulting profit of $350,000 must be disgorged and returned to SI.

In addition, SI originally contracted to buy the land for $500,000 but ultimately paid $1 million. SI can thus recover the damages of $500,000 due to Carole's breach.

Not Disclosing Confidential Information of Land Appreciation

As part of her duty of loyalty to SI, Carole has a duty to communicate all information in her possession that could be used for the corporation's advantage. The fact that the land that SI had obtained via contract was appreciating in value was relevant to SI's business objectives, since it could have decided to keep the land and then sell it later for a substantial profit. Carole's withholding of this confidential information thus marked another breach in her duty of loyalty to SI.

Corporate Opportunity

Related to her duty to communicate information, under the duty of loyalty Carole must present any corporate opportunities to SI first, and can only pursue them upon the board's decision not to pursue them on behalf of the corporation. Here, Carole became aware of a corporate opportunity through obtaining information that the land she had sold to SI was going to appreciate because of the mall development. She thus had a duty to present this opportunity first to the board, and only pursue it if they refrained.

Carole might argue that this does not apply since SI is in the business of sporting goods, not real estate speculation, and that therefore the corporate opportunity did not lie within SI's line of business. Modern authorities, however, state that a corporation may take opportunities broadly defined, even those outside their traditional line of business. Here, then, Carole had a duty to inform SI of the mall development and likely appreciation in land values, and she breached that duty.

Breach of Duty of Due Care

A director owes a duty of due care to the corporation, and must make decisions in the best interest of the corporation as if it were her own business. Here, it was clearly a breach of the duty of due care for Carole to engineer a rejection of a land sale contract at a very favorable price to SI.

Business Judgment Rule

The business judgment rule will normally protect directors whose decisions, made in good faith and with good business basis[sic], nevertheless result in adverse consequences. Here, however, Carole's efforts to seek release from her contract were not made in good faith. She was self-interested and desired to retain the profit from land speculation to herself at SI's expense, and Carole thus cannot be protected by the business judgment rule.

IV. Ethical Violations by Larry

Representation and Service on a Board

Although it is discouraged, a lawyer is allowed to serve as a board member on an organization he represents if he can do so effectively and without jeopardizing his ethical duties to the client organization. Here, Larry performed legal services for several years for SI, which was his client. At the time he accepted his board position, because there was no apparent conflict with his duties as lawyer, this acceptance was permissible.

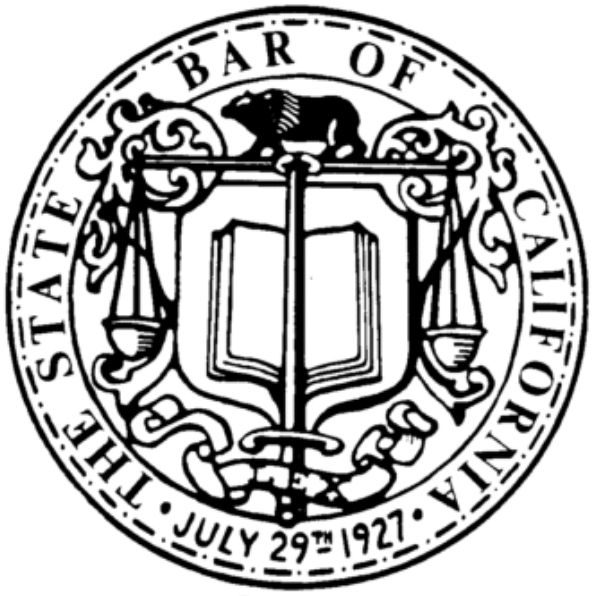
Duty of Loyalty – Conflicts between Clients
A lawyer owes a duty of loyalty to his client, and must act in his client's best interest. Here, Carole came over for dinner and sought advice regarding her plans to annul the contract. At the time, Carole informed Larry that she was seeking his legal advice, and a putative lawyer-client relationship between Carole and Larry formed.

A lawyer can take on a potential client conflict where 1) the lawyer believes he can reasonably and effectively serve all parties, 2) he informs each party, 3) each party presents written consent, and 4) that consent is reasonable. When Carole disclosed her plans, her interests became materially adverse to those of Larry's client, SI. At that point, Larry should have informed Carole that he could not represent her and urged her to seek independent counsel. His not doing so consti[t]uted a breach of his duty of loyalty to SI.

Duty of Communication
A lawyer has a duty to relay all helpful information to his client. Here, Larry learned that the land that SI had purchased was going to appreciate rapidly, and this information should have been related to his client. This duty, however, conflicted with his duty of confidentiality to Carole, which had attached because she sought legal advice from him. Though a close question, Larry's decision to honor Carole's confidence and not tell SI of the land value was probably correct.

Duty of Competence
A lawyer owes his client a duty of competence. Here, Larry did not disclose and breached.

Assistance in a Crime or Fraud
Under ethical rules, a lawyer must not assist a client in a criminal enterprise or fraud. Here, Carole approached Larry about cancelling the land sale contract because of Carole's desire to profit at the expense of SI. Larry's legal opinions led Carole to seek release from Bob, which involved breaches of fiduciary duties on behalf of Carole owed to SI. Larry might counter by noting that no actual fraud was perpetrated, since Carole never disclosed to Bob the reasons for seeking release. Nevertheless, Larry assisted in breaching a fiduciary duty, and thus breached ethical duties of his own.



California
Bar
Examination

Essay Questions and Selected Answers

July 2006

Question 4

Beth, Charles, and David are the directors of Web, Inc. (Web), a corporation that is in the business of creating websites.

Adco, Inc. (Adco), a corporation that markets computer advertising, had an urgent need for a complex website that would cost thousands of dollars to create. Adco approached Web about creating the website. Adco explained that it did not have the cash to pay for the work but claimed that it was a well-established corporation and asked Web to extend credit for the work.

Beth, Charles, and David unanimously agreed to take on the work, conditioned upon a prior review of Adco's financial statements and a determination of Adco's credit- worthiness. After learning this, Adco contacted David and told him that the sooner Web could start on the website, the sooner Adco would be able to pay Web.

David was anxious to obtain Adco's business. He falsely told Beth and Charles that he had obtained and reviewed Adco's financial statements and that, based on his review, "we should proceed with the work." Beth and Charles, without further inquiry, agreed, and Web created the costly website. Adco is unable to pay Web.

Beth, Charles, and David have now learned that Adco's shareholders have regularly taken its funds for their personal use.

In an unrelated transaction, Charles received a call from his friend Sam who wanted Web to create a new game website. Charles told Sam that the new game website was such a small job that he could do it at home for less money than Web.

Charles told Sam to send the payment for the game website to Charles at his home. Sam was pleased with the work and sent the check to Charles as requested. Shortly afterwards, Beth and David learned of this transaction.

1. What duties to Web, if any, have been breached by Beth, Charles, and David regarding the money lost on the Adco job? Discuss.

2. What rights, if any, does Web have against Adco's shareholders for Adco's failure to pay for the website? Discuss.

3. What rights, if any, does Web have against Charles regarding the contract with Sam? Discuss.

Answer A to Question 4

4)

1. Directors' Breach Regarding the Adco Job

Duty of Care:

Since corporate directors have a fiduciary duty to the corporation, directors of a corporation owe the corporation a duty of care. The duty of care requires that the directors act with good faith and the degree of care which a prudent person would proceed with in regard to his own business,

Here Adco asked that Web perform complex work that would cost thousands of dollars to create on credit. Adco claimed to be a well-established corporation, but the directors had a duty to investigate Adco's financial situation to determine whether it was safe and in the Web's best interest to extend credit for the work. Beth, Charles and David all agreed to take the work conditioned upon a prior review of Adco's financial statements. Their decision to review was correct, but they did not adequately follow through with it.

David, anxious to obtain Adco's business, decided to proceed with the work. This decision violated David's duty of care. David should have conducted a reasonable inspection of the financial records and then reasonably determined whether it was in the corporation's best interests to extend the credit. Instead, David made an uninformed decision. Further, David acted in bad faith by misrepresenting to the other directors that he reviewed the financial statements and made his determination to proceed based on information he obtained from them. Therefore, David clearly breached his duty of care to Web.

Charles and Beth relied on David's decision without inquiring further as to what was found in the financial reports. They will likely claim that the[y] reasonably relied on David's statements in making their decision and should, therefore, not be liable. However, Charles and Beth cannot completely delegate their responsibility to the corporation and should have at least inquired further about what David based his decision on. Because Beth and Charles blindly followed David's conclusory statement, they too violated their duty of care to the corporation.

Business Judgment Rule:

Directors may be protected under the business judgement rule. Courts will not second guess a business judgment if, at the time it was made, it was informed, reasonable (based on sound business judgment), and made in good faith. Directors will still be liable for decisions which are grossly negligent or reckless.

This will certainly not serve as a defense for David, who was not informed when making

his decision and acted in bad faith by lying to the other directors about having obtained and reviewed Adco's financial statements. Beth and Charles have a better chance to succeed with this defense since they did not act in bad faith and will claim that their reliance on Charles' decision was reasonable. However, it is likely that their decision to proceed in such a risky, costly and extensive project without any independent investigation or at least further inquiry was probably not sufficiently reasonable or informed under the circumstances. Therefore, they should not be able to be protected from liability from their breach by the business judgment rule.

2. Web's Rights Against Adco's Shareholders

General Rule Regarding Shareholder Liability

Generally, shareholders are not liable for the debts and liabilities of the corporation. One of the main benefits of the corporate form is that it provides limited liability; protecting shareholders from personal liability caused by corporate loss. This benefits the economy, because more risks are likely to be taken.

Piercing the Corporate Veil

Despite the general rule, courts may decide to pierce the corporate (PCV) veil and hold shareholders personally liable if there appears to be fraud or bad faith. Courts will often PCV if (1) the corporation is actually just an alter ago of the shareholders, or (2) the corporation was inadequately capitalized at its inception.

A corporation will be found to be the alter ego of its shareholders when there is serious lack of corporate formalities. If, for example, shareholder commingle corporate funds with personal funds, use corporate funds for any personal benefit, that would be grounds to PCV. Also, if meetings are not held or decisions are consistently made without meeting or voting, that may constitute grounds to PCV. Courts are generally more willing to PCV for the benefit of tort creditors than contract creditors, since contract creditors presumably had the opportunity to investigate and make an informed decision about whether to enter into the contract.

Here, it was determined that Adco's shareholders have regularly taken its funds for their personal use. This would constitute violating the corporate form and creates grounds to PCV. Web can successfully argue that Adco's shareholders are using the corporate form in bad faith to commit fraud use[,] then use the corporation as a shield from personally [sic] liability. It can argue that since Adco is operating as an alter ego and [sic] therefore, its shareholders should be held personally liable for Adco's liabilities. However, since Web voluntarily decided to enter into the contract and could have investigated before making their decision to assume the risk of doing business with Adco, they will have a higher burden. If Web can convince the court to PCV, it will be able to sue the shareholders of Adco personally to the debt owed.

3. Charles' Contract with Sam

Duty of Loyalty

Director has a fiduciary relationship with the corporation and has a duty of loyalty towards the corporation. The director must act in the corporation's best interests and not engage in any self dealing or receive personal gain at the corporation's expense. If a director comes across a situation which would breach his duty of loyalty, the director may cure the problem by disclosing it and getting approval by a majority of disinterested directors or disinterested shares.

Here, Charles did work that the corporation was entitled to and received personal profit from it. He therefore violated his duty of loyalty by acting in his own interest rather that [sic] the corporation's. If he really wanted to proceed with the work, he could tell the other disinterested directors about Sam's interest and see if a majority of disinterested directors or shares would decide that he could proceed to do the work on his own. In this case, he convinced Sam to allow him to do the work, received profit that the corporation could have had, and did so without proper disclosure and approval. Therefore, Charles breached his duty of loyalty to Web.

Usurping a Corporate Opportunity

A director should not usurp a corporate opportunity. A corporate opportunity is one which the corporation has a business interest or reasonable expectancy in. Something that is in the corporation's line of work/field will usually be deemed a corporate opportunity. If a director learns of a corporate opportunity in his capacity as director and wants benefit from it personally, he may be able to do so if he takes certain steps: (1) he must inform the corporation of the opportunity [and] (2) wait for the corporation to decline to take the opportunity.

Here, Web clearly had an interest in the job Sam was asking about. Sam wanted Web to create a new game website, which is exactly the kind of work Web does. As a business that creates websites, Web clearly has an expectancy interest in the work and would benefit (profit) from it. Charles usurped Web's legitimate right to the opportunity by convincing Sam that the job was small and that he could do it at home for less money than Web. Charles should have first disclosed the opportunity and waited to see if Web would have taken it. In this case, since the job is exactly in the line of work Web ordinarily conduct[s], Web would have likely taken the job. As a remedy, Web can recover any profit that Charles earns from performing the work for Sam.

<u>Charles's Defenses:</u>

Charles may argue that he learned of the corporate opportunity in his personal capacity,

from his friend, and not because of his position as director of Web. However, Sam called Charles asking for Web to create a new game website, not asking for Charles to do it personally. Therefore, Charles was being contacted in his professional capacity as director of the corporation, and will not succeed with this argument.

Answer B to Question 4

4)

(1) Beth, Charles and David breach with regard to Web

As directors of Web, Inc., Beth[,] Charles[,] and David owe a Duty of Care to the corporation. In their dealings for Web they must behave as a reasonably prudent person would with regard to his personal finances. All three directors have breached this duty.

David

David has breached the duty of care by failing to properly investigate Adco's finances and by falsely reporting to the other directors that he had investigated Adco's finances and falsely indicating that Adco's creditworthiness was sufficient to allow Web to extend Adco credit for Web's work.

All three directors initially made a responsible decision to investigate the financial condition and creditworthiness of Adco before extending credit for the work Adco wanted Web to do. However, David did not act as a reasonably prudent person would when he subsequently failed to make this investigation and instead misrepresented to the other directors that he had made an investigation and that Web should proceed with the work. A reasonably prudent person would not have extended credit without making any investigation into the finances and creditworthiness of the person or company to whom they were extending credit. Furthermore, David's failure to make any investigation cause[d] damage to Web because Web created a costly website for Adco and will not be paid for this work. Therefore, David has breached his duty of care and will be liable to the corporation for the damage that he caused.

Finally, David's conduct cannot be saved by the business judgment rule because he did not act in good faith after a reasonable investigation of the facts. He made no investigation and had none of the relevant facts. Furthermore, he did not act in good faith when he lied about having made an investigation.

David also probably [sic]

Beth and Charles

Beth and Charles have also breached their duty of care owed to Web because they too agreed to extend credit to Adco without making any investigation of Adco's creditworthiness. Again, after initially making a reasonable and prudent decision to investigate they did not car[r]y through and instead agreed to extend credit without making any investigation. A reasonably prudent person would not behave in this manner. Furthermore, it was not reasonable them to rely on David's assertion that he had

investigated and come to the conclusion that Web should proceed. Although directors are allowed to rely on the reports of officers of committees of directors assigned to perform a certain role (as well as the reports of officers of the corporation, accountants[,] etc[.]) directors may not delegate all their duties to a committee and serve simply as a "rubber stamp" for the committee's decisions. A director may not delegate his duty to make independent decisions. Therefore, Beth and Charles should have insisted on seeing at least some further information about the financial health of Adco so that they could evaluate for themselves whether the decision to extend credit was a good decision. This is, at minimum, what a reasonably prudent person would do with regard to their own finances. Web suffered damage as a result of Beth and Charles['] breach, and therefore these directors are personally liable to Web for the loss they caused.

Finally, Beth and Charles cannot take shelter in the business judgment rule because they did not act in good faith after a reasonabl[e] investigation. They made no investigation and knew none of the relevant facts. Therefore, their decision was not within the business discretion protected by the business judgment rule.

(2) Web's rights against Adco's shareholders

A company must maintain corporate form and structure if the shareholder's personal assets are going to be protected by the corporate form. The shareholders may not use the corporate form fra[u]dulently - as simply a cloak for their personal business activities. Therefore, the shareholders may not intermingle corporate and personal assets or take the corporation[']s assets for their personal use. When shareholders behave in this way, a court may disregard or pierce the corporate veil to hold the shareholders personally liable if justice requires it.

Here, Adco's shareholders have been regularly taking its funds for their personal use. Usually, a court will not pierce the corporate veil simply because a corporation is unable to pay its debts. Undercapitalization when a company is formed is usually required for veil piercing. However, if the shareholders have made an extensive practice of draining the corporate assets for their personal benefit, then it will appear that they have been abusing the corporate form to shield their personal business transactions from creditors. This pattern of behavior will introduce the required element of fraud.

The shar[e]holders who took the corporate assets probably cannot claim that they were just receiving dividends. A company cannot pay out dividends if paying the dividends will cause it to become insolvent (unable to pay its bills when they come due). Therefore, the shareholders (who seem to control Adco) will not be allowed to make themselves dividend payments and then not pay Web.

Web can make a strong case that a court should pierce Adco's veil to reach the shareholder's assets to satisfy Adco's debt to Web. The court will be able to reach the assets of those shareholders who engaged in the improper behavior (although the

shareholders who did not take part in the misbehavior will not be liable).

Even if a corporation's shareholders have abused the corporate form, a court will not pierce the corporate veil unless justice requires it. Furthermore, a court is generally more willing to pierce the corporate veil in tort situations than in contract situations since tort victims usually do not cho[o]se to interact with the corporation. Because Web has been harmed by Adco's failure to pay its debts, Web can argue that the interest of justice require[s] holding the shareholders personally liable. However, because Web did not make an adequate investigation of Adco before doing work for them, it may be more difficult for Web to prevail. On the other hand, Web can try to argue that Adco intentionally and fraudulently misrepresented its financial health to Web (both by saying it was a "well-established corporation" and that "the sooner Web could start on the website, the sooner Adco would be able to pay"), and that this weighs in favor of piercing the veil even though Web did not take all possible precautions to protect itself.

Finally, if Adco is a close corporation and the shareholders who were siphoning money from Adco were the same people who participated in negotiations with Web and David, then Web may be able to make a claim against them personally for fraud. To do this Web would have to show intentional misrepresentation (of fact) with the intent to induce reliance by Web, which did induce reliance and reasonable reliance by Web. It is unlikely they can show reasonable reliance on misrepresentations of fact.

(3) Web's rights against Charles

Corporate directors owe a duty of loyalty to the corporation. They must reasonably believe that their actions are in the best interest of the corporation. A director violates the duty of loyalty when he usurps a corporate opportunity and takes it for himself. A corporate opportunity is one in which the corporation has a reasonable expectation or one that is in the business of the corporation. A director cannot excuse taking a corporate opportunity by showing that the corporation would not have been able to take the opportunity. Before a director may take advantage of any corporate opportunity he must disclose it to the corporation and wait for the corporation to turn it down.

Here Charles took for himself a corporate opportunity (work) that should reasonably have gone to the corporation. He did not fully disclose the existence of opportunity to the other directors nor did he wait for the other (disinterested directors) to refuse the opportunity. Instead he did the work himself and was paid for it. Here it seems likely that Web would have been fully capable of doing the work (taking the corporate opportunity) but even if it wasn't this would not excuse Charles's behavior.

Charles is therefore liable to the corporation for the money he made by doing the work and must disgorge it to Web.

ESSAY QUESTIONS AND SELECTED ANSWERS

FEBRUARY 2007 CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the February 2007 California Bar Examination and two selected answers to each question.

The answers selected for publication received good grades and were written by applicants who passed the examination. These answers were produced as submitted, except that minor corrections in spelling and punctuation were made during transcription for ease in reading. The answers are reproduced here with the consent of their authors.

However, even where the offender's conduct is found to interfere with the property right of the injured, the court must determine if the interference is unreasonable. Unreasonableness is determined by balancing the hardships - balancing the interests and needs of the homeowners against the interests in having the business continue operating. During this process, the court will look at many factors including: whether the homeowners purchased their land at a discount because of its near location to the shopping center (coming to the nuisance), the offender's right to use his property as he wishes, the value of the business to the community including the number of employees, whether the nuisance can be abated by modifications of the offender's business, the length of time the offender has been in business, the possibility of using the property for some other purpose, the offender's investment in the business, etc.

In this case, certain factors indicate that the use by FF will be considered unreasonable. The offender has only been in business for a short period of time. It is unclear from the facts whether HO purchased at a discount based on nearness to the shopping center, but because the business is new the court is unlikely to find that HO came to the nuisance.

However, other factors indicate that the use by FF will not be considered unreasonable: FF has a right to use his property as he sees fit; FF has a right to use the shopping center property for a restaurant. Further, FF has put considerable investment into the operation as a FF establishment by purchasing top of the line equipment. This is not an unusual use for such a property. Further, it does not appear that the business could be abated. We know that FF is complying with all health ordinances and that the business is operated using the best equipment.

While the facts of this case will present a close call, the court is unlikely to find that there is a nuisance that should be abated. This is particularly true if there are a few number of warm days. The interest in allow [sic] FF to operate its business outweighs the interest of the homeowners for the reasons discussed above. As such, the court will not grant an injunction. However, if the court finds that there is some level of nuisance, the court may require FF to pay some measure of damages to HO to compensate them for their injuries arising from their nuisance.

Question 2

Rita and Fred wanted to form a corporation to be named “Rita’s Kitchen, Inc.” (RKI) for the purpose of opening a restaurant. They contacted 75 friends who agreed individually to become investors in RKI. Five of these investors also agreed to serve on the RKI Board of Directors with Rita and Fred.

Rita and Fred entered into a five-year lease with Landlord for restaurant space, naming “Rita’s Kitchen, Inc., a corporation in formation” as the tenant. They signed the lease as “President” and “Secretary,” respectively.

Rita and Fred retained Art as their attorney to form the corporation. They told Art that 75 of their friends had committed to invest and become shareholders of RKI. Irv was a duly appointed representative of the 75 investors. Rita, Fred and Irv met with Art, and they agreed that Art would represent Rita, Fred, and all the investors. After extensive discussions with Rita, Fred, and Irv about the operation of the proposed business, Art agreed to prepare the necessary documentation to incorporate RKI.

Later, outside of Irv’s presence, Rita and Fred asked Art to draft a shareholder agreement that would specifically designate Rita and Fred as permanent directors and officers of RKI and set Rita and Fred’s annual salaries at 12.5% of the corporate earnings. Without further discussion, Art properly formed the corporation. He then prepared the shareholder agreement, including the terms that Rita and Fred had requested.

The 75 investors each purchased their shares of stock and signed the shareholder agreement. RKI operated for one year but failed to make a profit. RKI ceased operations and currently owes three months of back rent under the lease.

1. Can Landlord recover the unpaid rent from Rita and Fred individually? Discuss.

2. Is the shareholder agreement valid? Discuss.

3. What ethical violations, if any, has Art committed? Discuss, including distinctions, if any, between the ABA Model Rules and California authorities.

Do not discuss federal and state securities laws.

Answer A to Question 2

2)

1. Can the Landlord recover unpaid rent from Rita and Fred individually?

Liability of Promoters on Pre-Incorporation Contracts

Until such time as a corporation complies with all formalities of incorporation and files its articles of incorporation, it does not have a separate legal existence, and cannot enter into contractual obligations such as a lease. Prior to incorporation, it is typical for the corporation's promoters and/or founders to enter into contracts on its behalf. Here, Rita and Fred entered into the lease with the Landlord on behalf of Rita's Kitchen, Inc. ("RKI"), which had not yet been formed. Under the law, a promoter remains personally liable on a pre-incorporation contract unless there has been a subsequent novation (ie., all parties agree to substitute the corporation for the promoters as the party liable on the contract whereby the promoters are thereafter relieved of further personal liability) or unless the contract is explicit in providing that the promoter has no personal liability on the contract.

Here, there has not been a novation to relief [sic] Fred and Rita of liability. However, they would argue that they entered into the contract on behalf of RKI, a corporation in formation, and signed as officers, and therefore made it clear that it was only the corporation and not them personally who would be liable on the lease. Their arguments would not likely succeed because the lease was not explicit in stating that they would not be personally liable thereunder. In the absence of such explicit language, the most likely result is that the court would hold that Rita and Fred as promoters are and remain personally liable on the lease. Therefore, the landlord should be able to recover the unpaid rent from either or both of them.

Indemnification from Corporation

Note also that it is not clear where RKI has ever ratified the lease. If no corporate action was taken to ratify the lease, then the corporation would not be liable thereunder, unless it silently took the benefits of the lease. Here, if RKI did not ratify the lease, it could still be held liable because it took the benefit of the lease without objection.

Note that although Fred and Rita would be held liable for the unpaid rent on the lease, they would have a claim for indemnification against RKI for any amounts that they had to pay personally to the landlord. They will not be able to recover, however, if the corporation does not have sufficient funds to pay.

2. Is the shareholders agreement valid?

As a general matter, shareholders of a privately held corporation such as RKI can and often do enter into shareholders agreements dealing with their rights and obligations as shareholders. These types of agreements commonly provide for matters such as transfer restrictions, rights of first refusal, put and call rights, "tags and drags", preemption rights and registration rights in the event that the corporation becomes public in the future.

Shareholders agreements can also provide shareholders with certain veto rights regarding the overall management of the company. In the context of a closely held private corporation, shareholders can also enter into a shareholders agreement whereby they become the directors of the corporation by agreement, thus doing away with the need to have a separate board of directors. In such situations, the shareholders step into the shoes of the directors and owe each other and the corporation duties as fiduciaries.

It appears that the shareholders agreement in question is problematic for two main reasons. First, it prohibits shareholders from exercising their rights as shareholders to be able to elect and fire directors. Secondly, it prohibits the directors from being able to exercise their responsibility for setting their compensation and the compensation of officers in accordance with principles of prudence and good faith.

Rights of Shareholders to Elect and Remove Directors

Shareholders have the right to elect and fire directors, both with and without cause. An agreement that prohibits shareholders from being able to exercise these powers would be contrary to public policy and likely unenforceable. At the very best, shareholders must have the authority to fire directors for cause (ie, breach of duty of care, duty of loyalty, etc.). To the extent that the shareholders agreement prohibits shareholders for exercising their powers as shareholders by giving Fred and Rita permanent directorships, it is invalid. While shareholders can agree as to the election of directors, directors cannot make themselves permanent and unremovable by way of a shareholders agreement.

Rights and Duties of Directors

A director is a fiduciary, and obligated at all times to act in the best interests of the corporation. A director has certain powers and obligations granted under the corporation's code and at law.

Right to Appoint and Fire Officers

The Board of Directors has the power to appoint and fire officers. The shareholders agreement is problematic because it usurps the authority of the Board to make this determination by making Rita and Fred permanent officers. Officers owe a corporation duties of care and loyalty, and cannot by agreement be made unremovable. At the very least, they must be removable for cause. Therefore, the provision in the shareholders agreement which makes Rita and Fred unremovable as officers is invalid.

Duty of Care and Business Judgment Rule

A director owes the corporation the duty to act as a reasonably prudent person in the management of his of her own affairs, in good faith and in the best interests of the corporation. In exercising his or her duty of care, a director can rely on the business judgment rule if he or she acted in a reasonable, informed manner, with due care and diligence, in exercising his or her judgment.

Duty of Loyalty

A director owes the corporation a duty of loyalty as a fiduciary to act in the best interests of the corporation and to avoid self-dealing to his or her own benefit and/or to the detriment of the corporation.

Breach of Duty of Care and Loyalty

Under the law, directors cannot, as a general matter, agree in advance as to how they will exercise their powers as directors. Here, the shareholders agreement in essence does just that – it provides that the directors (recall that the Board of Directors is made up of five of the investors, plus Rita and Fred) agree in advance not to fire Rita and Fred as officers. This the directors cannot do and, for this reason also, this provision is invalid.

This provision is also likely in violation of the directors' duty of care, because it is improper to agree to never remove officers, as there may be good reason and justification to remove Rita and Fred at some point in the future. Likewise, directors have the duty and obligation to set their own compensation and officers' compensation in accordance with reasonable, good faith parameters, taking into account the needs of the corporation and ensuring that they do not commit a waste of corporate assets in setting compensation. Agreeing in advance to what Fred and Rita's compensation is going to be - at 12.5% of corporate earnings - may constitute a violation of this duty, because it is unclear whether this figure will or won't be a reasonable and proper amount as the corporation moves forward.

Likewise, making themselves unremovable and giving themselves a fixed salary as a percentage of earnings, regardless of whether it is appropriate in light of the corporation's then financial circumstances, constitutes a breach of Fred and Rita's duty of loyalty to the corporation, as they are clearly putting their personal interests ahead of those of the corporation.

For all of the foregoing reasons, the provisions in the shareholders agreement are invalid.

3. What Ethical Violations has Art Committed?

An attorney owes his clients various duties under the applicable rules of professional responsibility. Chief among these is the duty of care, the duty of loyalty and the duty of confidentiality. One of the chief difficulties Art faces is that he has not separately addressed or differentiated between the different clients he represents. He has acted to incorporate RKI, and is arguably counsel to the corporation, whereby he would owe the corporation itself duties of care and loyalty. He is also apparently counsel for Fred and Rita in their personal capacities as incorporators and as officers of the corporation. Finally, he has acted as counsel for the investors in drafting the shareholders agreement. Art's main ethical violation stems from failing to differentiate between the potential and actual conflicting interests of his various clients and failing to advise them to obtain separate counsel as appropriate.

Duty of Care/Competent Representation

Art clearly acted as counsel for the investors by meeting with Irv and representing the investors' interest in drafting the shareholders agreement. In so doing, he breached his duty of competence to exercise the skill, knowledge and diligence that would be expected of an attorney practicing in his community. As discussed above, the shareholders agreements contain provisions that are not in compliance with applicable corporate law and corporate governance principles. Art should not have drafted an agreement containing provisions that are invalid and, in so doing, likely committed malpractice. Likewise, in his role as counsel for Rita and Fred, he should have advised them that the provisions that they sought would not be enforceable, and breached his duty to them in this regard also.

Duty of Loyalty

An attorney is obligated to act in the best interests of his client and cannot take on representation that will result in him not being able to properly represent a client on account of conflicting duties and obligations owed to other clients (for example, where one client's interests are adverse to another's). If an attorney is of the view that he can competently represent all of his clients, he is required to disclose to all that he is representing everyone's interests and to seek the written consent of each client to such joint representation.

Here, Art failed to obtain the written, informed consent all parties to his joint representation of each of them and, in so doing, breached his ethical obligations. Moreover, he failed to seek further consent when it became apparent that Fred and Rita's personal interests as officers (ie, to be permanently appointed and to obtain a guaranteed percentage of corporate earnings) came into conflict with the investors' interests as shareholders in maximizing the return on their investment and fully exercising their rights as shareholders. When it became apparent to Art that Fred and Rita's interests were different than those of the investors (ie, when Rita and Fred spoke to him outside of Irv's presence), he should have alerted them to the fact that he was representing the investors and the corporation and that he could not separately seek to represent their interests. He should have advised Fred and Rita to seek separate, independent counsel to negotiate their compensation and tenure packages with the corporation. Art also failed to alert Irv, as he was arguably required to do, of the validity and desirability (or lack thereof) that Rita and Art had requested. Art therefore failed to fulfill his ethical responsibilities to all clients involved.

Answer B to Question 2

1. Can Landlord recover unpaid rent form Rita (R) and Fred (F)?

Promoter Liability

A promoter is a person who works prior to the incorporation of an entity to secure contracts and services for the to-be-formed entity. A promoter has a fiduciary duty to the other promoters and to the entity to be formed. A promoter can enter agreements on behalf of the to-be-formed entity but can be subject to liability on those agreements.

Adoption and Novation

A corporation does not become liable on a contract entered by a promoter until it adopts the contract. A contract can be adopted expressly by the corporation agreeing to be bound or impliedly by the corp. choosing to accept the benefit of the promoter's contract. Here, there is nothing to indicate that RKI expressly adopted the terms of the lease entered into by their promoters - R and F. However, RKI did accept the benefit of the lease by using the space for its restaurant. Thus, RKI will be bound on the lease.

R & F are also bound

The corporation's act of adapting a contract does not absolve the promoters from liability unless there is an express provision in the contract or a novation in which the corp. and the other party agree that the promoter will not be liable. Here, there is nothing on the lease to indicate R and F would not be liable. It only says they signed as Pres. and Sec. of RKI, "a corporation in formation". Further, there is no evidence of an agreement or novation after RKI was formed absolving them of their liability. Thus, there is no novation and R and F will still be individually liable on the lease with Landlord for the unpaid rent because they were promoters who were not relieved of liability.

2. Is the Shareholder Agreement Valid?

To have a valid shareholder agreement, there needs to be approval from the shareholders. Here, we are told that each of the 75 investors signed the shareholder agreement. Thus, the shareholder agreement is presumptively valid but the terms of the agreement must be examined.

Election of Directors

Directors of a corporation are elected by shareholders at the corporation's annual meeting. Here, the shareholder agreement specifically designated R and F as permanent directors and officers of RKI. By having this provision in the shareholder agreement, the agreement purports to strip the shareholders of their ability to elect directors annually. In this regard, it is invalid.

Removal of Directors

Along with the ability to elect directors, shareholders also have the ability to remove directors with or without cause. The provision of this shareholder agreement indicates that

R and F would be permanent directors. Because shareholders have the ability to remove a director, no director can be permanent. Thus, to the extent the shareholder agreement purports to make R & F permanent directors, it violates the right of shareholders to remove a director and is invalid.

Shareholders Can't Have a Predetermined Agreement of How They Will Vote if Elected Officers [sic]

Shareholders may have agreements for how they will vote on shareholder elections but can't agree to how they will vote as directors. To the extent this shareholder agreement commits R and F along with the 5 other investors who agreed to serve on the RKI board to elect R and F as officers and to set R and F's annual salaries at 12.5% of corporate earnings, it takes away their ability to act in their fiduciary capacity as duly elected directors and is invalid.

Board Decides Its Own Salaries

A board of directors is charged with the management of the company and makes decisions for the company on things such as their salaries. Here, the SH agreements purports to set R and F's salaries. Because the board, and not the shareholders, have the power to manage the company, the shareholders cannot set director and officer compensation. To the extent the SH agreement tries to do this, it is beyond the shareholder's powers and invalid.

Board Elects Officers

Another power inherent in the board of directors is the power to elect officers. Shareholders may have the power to elect directors but they can't elect officers. Thus, to the extent that shareholder agreement elects R and F as permanent officers of RKI, it is invalid because the directors, not the shareholders, are responsible for electing officers.

Thus, while the shareholder agreement as signed by all shareholders is presumptively valid, it is invalid to the extent it improperly elects directors and officers, it does not provide for removal of directors, it binds shareholders to how they will vote as directors, and it improperly sets director and officer compensation.

3. Art's Ethical Violations

Who Does Art Represent?

The first issue in deciding whether Art (A) committed any ethical violations is to determine who Art represents. Here, Art was originally approached by R and F to form the corporation. Also, A met with R and F as well as Irv (I) who was the duly appointed representative of the 75 investors. After meeting with R, F, and I, A agreed to prepare the necessary documentation to incorporate RKI. As a result, A potentially represents R & F, Irv and two other investors, and RKI, the corporation he helped form.

Duty of Loyalty

An attorney owes his client the duty to exercise his professional judgment solely for

the client's interests. If the interest of the attorney, another client or a third person may materially limit the attorney's representation or becomes adverse to the client's interests there is an actual or potential conflict of interest. When an attorney is presented with a conflict, he can only accept or continue the representation if he reasonably believes he can effectively represent all parties, he informs each party about the potential conflict, and the client consents to the representation in writing.

Without consent, an attorney should refuse to take the representation or withdraw from the representation.

A representing R & F and Irv and the Investors

Here, A has a potential conflict by representing both R & F as well as Irv and the investors. While A can say that R, F, and I all had the same interests and wanted to incorporate RKI, because he was representing multiple interests, he needed to be aware of potential or emerging conflicts.

When R & F approached A to draft the shareholder agreement without Irv being involved, A should have been suspicious. When he learned that they wanted the agreement to designate them as officers and directors and set their salaries, their interests were potentially conflicting with I and the investors. At that point, A should have disclosed the proposal to Irv and obtained written consent from I to draft the agreement as requested by R and F. It is also unlikely that a reasonable attorney would believe he could adequately represent both R and F and the investors.

In any event, A should have sought written consent from Irv. Because he did not, he violated his duty of loyalty.

Duty of Confidentiality

A lawyer also has a duty not to reveal anything related to a client's representation without consent. Thus, A can argue that he couldn't tell Irv about his conversation with R & F outside of his presence without violating his duty of confidentiality to R & F. If this is the case, A should have withdrawn from his representation of Irv and the investors and advised them to seek independent counsel re: the shareholder agreement.

Duty of Competence

A lawyer owes his client the duty to use the legal skill, thoroughness, preparation, and knowledge necessary and reasonable for the representation. Here, A had a duty to competently draft the shareholder agreement. For all the problems pointed out above about the shareholder agreement, A violated this duty.

Duty to Communicate

An attorney owes his client a duty to communicate about the matters of the case. Here, A had a duty to tell Irv about the provisions he was drafting in the agreement. Again, A would claim he could not communicate this to I without breaking his duty of confidentiality to R & F. As mentioned above, this again meant A should have withdrawn from the

representation of at least Irv and possibly R & F and urged the parties to seek independent counsel.

Art's Defense

Art will argue that any potential problems were avoided because the investors signed the agreement with the term R & F requested. However, the ends do not justify the means. A had ethical obligations to his client during the representation that he breached. Their later approval of the agreement does not equal informed consent to his breaches throughout.

ESSAY QUESTIONS AND SELECTED ANSWERS
FEBRUARY 2008
CALIFORNIA BAR EXAMINATION

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Question 6

Albert, an attorney, and Barry, a librarian, decided to incorporate a business to provide legal services for lawyers. Barry planned to perform legal research and draft legal memoranda. Albert intended to utilize Barry's work after reviewing it to make court appearances and argue motions on behalf of other attorneys. Albert and Barry employed Carla, an attorney, to prepare and file all of the documentation necessary to incorporate the business, Lawco, Inc. ("Lawco").

Carla properly drafted all required documentation to incorporate Lawco under the state's general corporation law. The documentation provided that: Lawco shares are divided equally between Albert and Barry; Lawco profits will be distributed equally to Albert and Barry as annual corporate dividends; Barry is president and Albert is secretary.

Albert and Barry opened their business in January, believing that Lawco was properly incorporated. In February, they purchased computer equipment in Lawco's name from ComputerWorks. The computer equipment was delivered to Lawco's office and used by Barry.

Carla, however, neglected to file the articles of incorporation until late April.

In May, Albert, without consulting anyone, contracted in Lawco's name to purchase office furniture for Lawco from Furniture Mart. On the same day, also without consulting anyone, Barry contracted in Lawco's name to purchase telephones for Lawco from Telco.

1. Is Lawco bound by the contracts with:
    a. ComputerWorks? Discuss.
    b. Furniture Mart? Discuss.
    c. Telco? Discuss.

2. Has Albert committed any ethical violation? Discuss.

Answer question number 2 according to California and ABA authorities.

Answer A to Question 6

1A) Lawco's Contract with Computer Works

Status of the Corporation

The first defense Lawco might raise against enforcement of this contract is that while it was entered into by Lawco, Inc., no such entity existed at the time the contract was formed. They might argue that because no corporation existed, the corporation is not liable on the contract. There are three scenarios under which a corporation might be bound.

If the corporation is a de jure corporation, it has been validly created by observing the formalities of incorporation and receiving its articles of incorporation from the state. While the second and third contracts discussed below were entered into by a de jure corporation, this first one was not, as attorney Carla had neglected to file the articles of incorporation with the state until April, two months later.

A corporation is a de facto corporation where the formalities have been entered into, and the corporation had a good faith belief that it is a corporation, but the paperwork has not been processed and the state has not actually issued corporate status. A corporation can rely on its de facto status in such a situation to enforce a contract that it might not otherwise be able to enforce. Here, A and B both believed that Lawco had been properly formed, though it had not yet been so. If they wanted to enforce the contract, they would depend on their de facto status. If they are trying to avoid being bound by it the de facto characterization might be considered, but the doctrine of corporation by estoppel is probably more appropriate.

Corporation by estoppel results when a corporation holds itself out to the public as a corporation, acts as such, and enters into contracts under that banner, but is not actually a corporation at the time. Such an entity is estopped from claiming that it was not in fact a corporation when it entered into those contracts, as it benefited from claiming that it was.

Adoption of Pre-Incorp Contract

Even if none of the doctrines above are successful, ComputerWorks (CW) will argue that the contract was a pre-incorporation contract and that Lawco adopted it by accepting and using the computers that it delivered. It will argue that such actions demonstrate its intent to profit from the contract.

Quasi-Contract

If no contract is found, CW will argue that Lawco benefited from the use of its computers after holding itself out as ready to contract and that under the doctrine of quasi-contract, should not be unjustly enriched. Under such a theory, CW will receive the value conferred upon Lawco.

Sue A and B personally

If none of the above work, CW can sue whomever signed the contract (A, B, or both) and claim that it was a pre-incorporation contract which was not adopted by the corporation and hold them personally liable.

1B) Lawco's contract with Furniture Mart (FM)

As described above, Lawco was a validly formed corporation when it entered into a contract with FM for furniture. The issue is whether or not Albert, by himself, had authority to enter into such a contract, or whether B's consent was required. This issue is best analyzed under the law of agency.

Agency

If FM can establish that A was acting as an agent of Lawco when he entered into the contract, then Lawco will be bound. An agent can have actual or apparent authority.

Actual Authority

Actual authority can be either express or implied. Actual authority is express when the agent and principal have agreed that the agent will act on behalf of the principal in a certain capacity. Authority can be implied to the extent that an agent's express authority requires it to do certain other acts as a matter of course in order to perform its functions as an agent.

In this case, A entered into the contract with FM. Under the articles of incorporation, A is the secretary of Lawco. While there is no evidence of express authority for A to purchase for Lawco, a corporation is not an individual and so must act through agents by necessity. Lawco will argue that as a 50% shareholder, A needed to have approval of B in order to enter into a contract to purchase assets for the corporation and that he was not an agent. It is much more likely that B will possess actual authority than A will, and this argument will probably fail.

Apparent Authority

If the argument for actual authority fails, FM will argue that, instead, A had apparent authority to act for Lawco. Apparent authority is authority that results from 1) an agent's position or title with respect to the principal, 2) where the principal has held the agent out in the past as its agent and has not published the revocation of authority, or 3) the principal ratifies the agent's actions after the fact.

In this case, FM will argue that because of his position as secretary of the corporation, even if A did not have actual authority to contract, they relied on his apparent authority to do so as the secretary of the corporation. This will be a weak argument, as the secretary is not usually expected to enter into contracts for a corporation. Although the facts are silent as to what happened after the contracts were entered into, if Lawco accepted the benefits of the contract with

FM, they will also argue that Lawco ratified the contract entered into by A when they accepted the furniture and used it.

Lawco will argue that A's role in the corporation was a 50% shareholder and secretary. It will argue that there was no express agency agreement, nor did it ever act in a manner that might hold A out as its agent. Futhermore, A's shareholder status grants him no right to enter into contracts on behalf of the corporation as that is a job for the officers and directors. Finally, A's role as a secretary is to take notes at meetings, and perhaps oversee documents. It is not to make unilateral decisions for the corporation or spend money.

Unlike the situation of B below, FM will not have access to some of the more persuasive arguments of apparent authority. Unless there is some manifestation of express authority in the corporate records, absent a decision by the officers or vote of all shareholders, they will probably not be able to bind Lawco under A's contract, unless Lawco takes some action after the fact to ratify A's actions. They may, however, be able to go after A personally for any damages due to breach on a contract he signed as a purported agent.

1C) Lawco's Contract with Telco (TC)

As described above, Lawco was a de jure corporation when B entered into the contract with TC on its behalf. As above with A, the issue will be whether B qualifies as an agent who might bind Lawco as the principal. Unlike A, however, who was the secretary of Lawco, B was the president. The president arguably has actual or apparent authority to enter into contracts for the corporation where the secretary is less likely to have such.

The same principles will be applied as above, but in this case, the facts probably dictate a different outcome. The president of a corporation is arguably an agent thereof by [the] very nature of his position. FM will argue that for a necessary business expense of the corporation, like securing furniture, the president had actual or at least implied authority to secure them. They will argue that the corporation cannot act on its own and that its president is the obvious choice to enter into contracts on behalf of it. They will also argue that Lawco accepted the benefit of B's actions and that in doing so it ratified B's actions.

TC will have access to more persuasive arguments than FM had above due to B's apparent authority as president, and will have a much stronger case to enforce its contract against Lawco than FM did.

2) Albert's Ethical Violations

Albert's Duty Not to Aid in the Unauthorized Practice of Law

A has a duty not to help a nonlawyer practice law. The practice of law includes advising or counseling clients, as well as arguing before the court. In this case, the facts state that B's duties are to perform legal research and to draft legal memoranda. A intends to review this work and use it to make court appearances

and argue motions. While B's legal research is probably not prohibited, his drafting of legal memoranda may be. The fact that A intends to review this work and basically attach his name to it after verifying its contents makes it a close call. Law clerks are able to engage in such activity before graduating from law school and passing the bar as long as they are appropriately supervised. A will argue that B's work is almost identical to that of a law clerk and that with proper supervision there is no breach of his duty.

Albert's Duty Not to Go Into Business With a Nonlawyer

A has a duty not to incorporate with a nonlawyer when he plans to practice law. Lawyers are allowed to form partnerships with each other, but they cannot form partnerships or corporations with another type of professional or nonlawyer such as a CPA. Here, A will argue that the actuality of the relationship is exactly like a lawyer – experienced paralegal. He is mistaken, however, in that the liability of Lawco, the ownership interests, and the division of power between A and B are almost exactly equal. A should not allow himself to enter into a business transaction with a nonlawyer like B who may try to exert influence on his decisions in legal matters as a result of his partial ownership in the venture. The fact that B is the president and A is the secretary makes this arrangement particularly suspect. B arguably has a persuasive role in determining the direction of the venture due to his office. Furthermore, he is the face of the venture that is in its very name offering legal services, yet he is not himself a lawyer. A has violated this duty.

A's Duty Not to Share Profits with A Nonlawyer

A has a duty not to share profits with a nonlawyer in his practice of law. Lawyers may hire paralegals or research assistants for salary, but arrangements under which a nonlawyer is entitled to a preset ratio of the profits is forbidden. In this case, Lawco's articles provide that Lawco's profits are to be distributed equally to Albert and Barry as annual corporate dividends. The form the profit sharing takes is not nearly as important as the fact that it exists. A will not be able to hide behind the fact that the distribution scheme is couched in dividends rather than an outright sharing. A has violated this duty.

Answer B to Question 6

1A) Contract with ComputerWorks

In [order] for Lawco to be bound, (i) the corporation must be validly incorporated, (ii) the doctrines of de facto corporations or corporations by estoppel must apply or (iii) the contract must have been adopted by the corporation after incorporation.

Valid Incorporation

A corporation is formed when the incorporator validly complied with the requirements of the state's general incorporation law. This typically requires the filing of the articles of incorporation. Since the articles were not filed until April and the contract was entered into in February, Lawco was not validly incorporated at the time of the contract.

Generally, a corporation is not liable for contracts entered into before it was incorporated until it adopts the contract. It can adopt the contract through (i) express adoption, such as a writing, or (ii) implied adoption, which may be accomplished by accepting the benefits of the contract without protest.

De facto Corporation

ComputerWorks could argue that Lawco is still liable on the contract since it was a de facto corporation. A de facto corporation may be found where (i) there is a valid general corporation law, (ii) the incorporation made a colorable good faith attempt to comply with the statute, (iii) the incorporator was not aware that the attempt to comply with the statute was invalid and (iv) the corporation took some action indicating that it considered itself a corporation.

In this situation, Carla properly drafted all the required documentation to incorporate Lawco. The state does have a general corporation law. Albert and Barry entered into the contract with ComputerWorks believing that the corporation was valid. The corporation took an action typical of a corporation by purchasing computer equipment in the corporation's name and having the equipment delivered to the corporation's office and used by a corporate employee.

This question of de facto corporation will revolve around whether Carla's neglect in delaying the filing of the articles negates her "good faith, colorable" attempt to comply with the corporation statute. Since Carla is a lawyer and knew her job was to prepare and file all the documentation necessary to incorporate Lawco, it is likely that this is not a good faith, colorable attempt to comply with the statute, and there is no de facto corporation.

Corporation by Estoppel

ComputerWorks can argue that Lawco should be estopped from denying the corporation existed since it received a benefit under the contract and would be unjustly enriched if the contract were not enforced. ComputerWorks can argue that there was (presumably) a promise to pay. ComputerWorks can argue that Lawco received a benefit by accepting and using the computers. It would be unjustly enriched by retaining the computers without paying for them. ComputerWorks can argue that it was foreseeable that it would expect to be paid for the computers and it was reasonable that it should be paid for the computers.

Adoption of the Contract

Finally, ComputerWorks could argue that Lawco should be bound on the contract since it adopted the contract after formation. A corporation adopts a contract after formation when it impliedly accepts the benefits of the pre-incorporation contract after incorporation. Here, Lawco retained the computers and probably continued to use them after formation in April.

The result is that the court would likely find that Lawco adopted the contract, or if not, that it should be estopped from denying the contract.

1B) Contract with Furniture Mart

In order for Lawco to be bound, (i) the corporation must have been validly incorporated at the time of the contract and (ii) the action taken must validly bind the corporation.

First, since the articles were filed in April, and it is presumed that all other requirements of the statute have been complied with, Lawco was validly in existence at the time of its contract with Furniture Mart in May.

Express Authorization by Articles

Second, there is the issue whether Albert validly bound Lawco when he contracted in Lawco's name with Furniture Mart. Albert is the secretary of the corporation and is thus a senior officer. The articles of the corporation would likely delineate the powers of the officer, and so Albert may be authorized under the articles.

Implied Authorization under Agency Law

If not, Albert may also be authorized under general principles of agency law to bind the corporation. Generally, an agent may bind a principal if he has express authorization, implied authorization or apparent authorization to do so. There is no evidence that Albert received express authorization to enter into the contract.

Albert would have implied authorization if (i) it was customary for someone in his position to bind the corporation, (ii) he reasonably believed, based on past behavior and actions, that he had the power to do so, or (iii) it was necessary for the performance of his duties that he be able to bind the corporation. It is also necessary that Albert acted within the scope of the authorization.

Since it is probably necessary for Albert's position as secretary that he be able to bind the corporation on such routine contracts as buying office furniture, he probably had implied authority.

He may also have had apparent authority if (i) the corporation "cloaked" him with the apparent position of being able to enter into the contract and (ii) Furniture Mart relied on this position.

In conclusion, even though he did not consult anyone, it is likely that the contract is valid since Albert had implied and apparent authority to enter into the contract. Since the contract is valid, Lawco is bound on the contract.

1C) Contract with Telco

In order for Lawco to be bound, (i) the corporation must have been validly incorporated at the time of the contract and (ii) the action taken must validly bind the corporation.

First, since the articles were filed in April, and it is presumed that all other requirements of the statute have been complied with, Lawco was validly in existence at the time of its contract with Telco in May.

Please see part (1)(B) for detailed discussion of agency law. Below is the application of the discussed legal principles to this situation:

Express Authorization by Articles

As President, it is likely that Barry was expressly authorized by the articles to enter into routine contracts, such as the purchase of telephones, for the corporation.

Implied Authorization under Agency Law

If not, Albert may have validly entered into the contract by express, implied or apparent authority. The facts give no indication of express authority. However, it is probably necessary for the president of a corporation to enter into contracts for routine items, so he probably had implied authority. It is also perfectly reasonable for another corporation to believe that the president has the power to bind the company, so Barry definitely had apparent authority.

In conclusion, even though he did not consult anyone, Barry had apparent and implied authority to enter into the contract, and Lawco is thus bound by the contract.

2. Possible Ethical Violations by Albert

Unauthorized Practice of Law

An attorney may be disciplined for aiding a nonlawyer to practice law. The practice of law consists of making decisions which require the exercise of legal judgment by the lawyer. However, activities related to law, which do not involve the "practice of law," may be performed by any nonlawyer. Also, under the ABA Rules and California law, a nonlawyer may practice law under certain very specific circumstances. For example, under ABA Rule, a nonlawyer may practice law under the direct supervision of a practicing lawyer who is licensed in that jurisdiction.

Albert is an attorney, and he knowingly decided to incorporate a business in which Barry, who is not an attorney, would perform legal research and draft legal memoranda. Not only did Albert know that Barry would be doing these things, he intended to use Barry's work to make court appearances and argue motions. There is no mention of Albert supervising Barry or reviewing his work before using it. Therefore, Albert can be disciplined for assisting Barry in the unauthorized practice of law.

Partnering with Nonlawyers

A lawyer is permitted to partner with a nonlawyer in a business providing legal services. A lawyer may hire a nonlawyer to work in such a business as long as they are not practicing law in an unsupervised way.

Here, Albert, a lawyer, and Barry, a nonlawyer, incorporated to form a business together. The business was specifically to provide legal services. The shares of business would be divided equally between Albert and Barry. Therefore, Albert may be disciplined for partnering with Barry to perform legal services, in a corporation in which they have equal shares.

Splitting Fees with Nonlawyers

A lawyer is not permitted to split fees with nonlawyers, except in certain very specific circumstances, such as employee benefit plans. Albert could argue that he was not splitting fees with Barry, and that fees for his services would be paid to the corporation. However, profits are distributed equally to Albert and Barry as corporate dividends. Therefore, Albert would be disciplined for splitting fees with Barry since his argument that fees are not split is illusory.

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ESSAY QUESTIONS AND SELECTED ANSWERS
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Question 6

Stage, Inc. ("SI") is a properly formed close corporation. SI's Articles of Incorporation include the following provision: "SI is formed for the sole purpose of operating comedy clubs." SI has a three-member Board of Directors, consisting of Al, Betty, and Charlie, none of whom is a shareholder.

Some time ago, Charlie persuaded Al and Betty that SI should expand into a new business direction, real estate development. After heated discussions, the board approved and entered into a contract with Great Properties ("GP"), a construction company, committing substantial SI capital to the construction of a new shopping mall, which was set to break ground shortly.

Although Charlie remained enthusiastic, Al and Betty changed their minds about the decision to expand beyond SI's usual business. SI was struggling financially to keep its comedy clubs open. Al and Betty decided to avoid SI's contract with GP in order to devote all of SI's capital to its comedy clubs.

Last month, GP approached Charlie about another real estate project under development. GP was building a smaller mall on the other side of town and was seeking investors. Aware that Al and Betty were unhappy about the earlier contract with GP, Charlie believed that SI's board would not approve any further investments in real estate. As a result, Charlie decided to invest his own money in the endeavor without mentioning the project to anyone at SI.

Meanwhile, Al and Betty have come to suspect that Charlie has been skimming corporate funds for his personal activities, and, although they have little proof, they want to oust Charlie as a director.

1. Under what theory or theories might SI attempt to avoid its contractual obligation to GP and what is the likelihood of success? Discuss.

2. Has Charlie violated any duties owed to SI as to the smaller mall? Discuss.

3. Under what theory or theories might Al and Betty attempt to oust Charlie from the Board of Directors and what is the likelihood of success? Discuss.

Answer A to Question 6

Stage, Inc. (S) vs. Charlie

1. The issue is whether Al and Betty can avoid its contractual obligations to GP under the theory that the contract is ultra vires (outside scope of corporations purpose). Ultra vires statement is the corporation's statement of purpose and can either be broad and indicate that the corporation is incorporated for the purpose of "conducting lawful business" or can be as specific as Stage, Inc.'s and indicate that "SI is formed for the sole purpose of operating comedy clubs." At common law, if a corporation acts outside the scope of its statement of purpose, the contract is voided. At modern law, when a corporation conducts ultra vires activities, the transaction is valid; however, individual directors and officers who enter into the transaction can be held personally liable. Here, SI's Articles of Incorporation include the provision that SI is formed for the sole purpose of operating comedy clubs and decided at a later point to expand into the real estate development area.

In entering into the contract with Great Properties (GP), a construction company, and committing substantial SI capital to the construction of a new shopping mall, SI has acted outside its statement of purpose because the business of real estate is wholly different and apart from the business of running comedy clubs. Thus, SI has committed an ultra vires act and, modernly, it cannot avoid its contractual obligations with SI. The corporation's assets, however, will not be liable for the act of its Board of Directors, but the directors can be held personally liable for entering into an ultra vires act. Thus, although SI may not be able to void the contract, its assets are protected and Al, Betty, and Charlie will be held personally and be responsible for damages to GP.

2. The issue is whether Charlie has violated his duty of loyalty to SI by investing money into GP's project of building a smaller mall. A director owes the

corporation a duty of loyalty to act in good faith and in the best interest of the corporation. One of the several ways a director can violate his duty of loyalty to the corporation is by usurping a corporate opportunity. Before taking a business opportunity upon himself that he reasonably believes the corporation would be interested in, the director must inform the corporation of such opportunity and wait for the corporation to reject it. It is important to note that it is not a valid defense to state that at the point the corporation was not adequately financed to take on the opportunity.

The courts use the interest/expectancy test in order to determine whether an opportunity is one that the director should believe the corporation is interested in. Here, the corporation's statement of purpose is to operate comedy clubs and not deal in real estate; thus, the business opportunity is not within the corporation's line of business. Further, given that Charlie, Betty, and Al engaged in heated discussions before approving and entering into the contract with GP and given that Al and Betty later changed their minds about the decision and sought to void its contractual obligation to GP, it was reasonable for Charlie to believe that the opportunity was one that SI was not interested in. Also, the facts also state that Al and Betty decided to devote all of SI's capital to its comedy clubs since it was short on capital and struggling financially to keep its comedy clubs open. Finally, the facts state that Charlie was aware that Al and Betty were unhappy about the earlier contract with GP and believed that SI's board (which consisted of Al, Charlie, and Betty) would not approve any further investments in real estate. Thus, given the fact that the business of real estate development was out of SI's line of business and one that they would not likely be interested in taking advantage of, Charlie did not usurp a corporate opportunity and did not violate his duty of loyalty to the corporation in investing in the smaller mall with GP.

3. The issue is whether Al and Betty could oust Charlie from the Board of Directors for fraud and gross abuse of authority and for violating his duty of due care to the corporation.

Duty of Due Care

A director owes the corporation a duty of due care and must act as a reasonable prudent person and run the business as if it were his own. A director who takes action that harms the corporation (misfeasance) will be liable to the corporation unless he can defend himself under the business judgment rule. Here, if Charlie did in fact skim corporate funds for his personal activities as Al and Betty suspected, and if they could prove such activities, Charlie has violated his duty of due care to the corporation because a reasonably prudent person would not embezzle funds from a corporation. Under these facts, he will not be able to defend under the business judgment rule because that requires a showing that he acted in good faith and made a reasonably and well informed decision. It would be difficult and near impossible to show he was acting in good faith for the corporation's interest in embezzling money for personal use. Thus, he has violated his duty of due care to SI.

Removal of a board member for fraud and gross abuse of authority

The issue is whether Al and Betty would be able to remove Charlie from the Board of Directors for his acts of skimming corporate funds for his personal activities. A Director may be removed from the board by court order for fraud or gross abuse of authority or by a vote of the majority of shares of the corporation for any reason. Here, given that the corporation is a closed corporation with no shareholders, Al and Betty can petition the court to remove Charlie if they can show that he engaged in fraud or gross abuse of authority as a director of SI.

Here, the facts state that Al and Betty only suspected Charlie of skimming corporate funds for his personal use and had little proof of his unlawful activities. Further, Charlie would likely argue that SI has been struggling financially and thus it is unlikely that he was able to skim funds from SI. Additionally, the fact that Charlie was able to invest his own funds into the mall project with GP may

show that he is financially stable enough to not have to skim funds from a struggling corporation. Finally, Charlie could also defend himself on the grounds that perhaps Al and Betty are acting in retaliation because they resent him for convincing them to enter into the contract with GP which they wish to rescind at this point.

Unless Al and Betty can show clear proof that Charlie has engaged in such fraud, it is unlikely that the court will oust Charlie from his position as Board Member of SI.

Answer B to Question 6

I. SI's Ability to Avoid the Contract with GP

SI may attempt to avoid its contractual obligations on the basis that it was an ultra vires act. A corporation may only engage in activities which fall within the stated business purpose in its Articles of Incorporation. SI's Articles explicitly stated that it was formed for the sole purpose of operating comedy clubs. The contract with GP had nothing to do with comedy clubs, but rather was for an investment of capital into construction of a new shopping mall. Traditionally, corporations could always void contracts that were ultra vires and, in a jurisdiction that retains that approach, SI would prevail on this theory. SI could make a strong argument that the use of the term sole purpose left no ambiguity as to whether SI was able to take action in the form of real estate development. Modernly, however, most corporations are allowed to engage in any legitimate business purpose and are not able to void contracts on the mere claim that they were ultra vires. This protects the other contracting party from being abandoned if the corporation determines that the contract would not be profitable and then cites their Articles of Incorporation, which the other contracting party probably had no notice of, as a reason to evade contractual obligations. Insofar as that is exactly what is happening here (Al and Betty knew what the stated purpose of their corporation was and discussed and approved entering into the area of real estate development, then had second thoughts because of SI's struggling financial position), this theory may not work. Furthermore, the shareholders would have to bring the suit and SI is a close corporation, so it may be unlikely that a court would believe that the directors acted in complete defiance of the shareholder's wishes. Finally, it could be argued that investing in real estate is a way to earn capital that would ultimately be used to operate their comedy clubs, and thus the contract was actually within the corporate purpose.

The shareholders of SI may argue that the directors had no authority to enter into the contract and that the corporation should not be bound by the unauthorized acts of its agents. This would require showing that the directors had no actual, implied, or apparent authority to contract with GP and would likely fail. The entire Board of Directors approved the decision to expand in the direction of real estate development after heated discussion and subsequently entered the contract with GP. The directors of a close corporation most likely have implied, if not actual, authority to conduct the business of the corporation by approving and entering contracts. The role of the Board is to manage the corporation's affairs and make decisions about actions to be taken by the corporation. Often the actual authority to pursue those approved actions would be vested in a corporate officer like a president, but the small size and nature of a closely-held corporation typically implies a more fluid power structure. If there are, in fact, officers who are expressly vested with exclusive authority to enter [into] contracts on behalf of SI and none of the directors hold those officer positions, then SI may be able to avoid the contract on the basis that it was an unauthorized act. However, at the very least, it is likely that the directors held themselves out to GP as having authority to bind the corporation such that GP could argue they had apparent authority and prevail in enforcing the contract. Finally, the Directors did approve the decision, so it is likely that they ratified the contract in some way even if it was entered into by someone without authority.

The easiest way for a corporation to avoid a contract is not present here. If SI had not yet been formed and someone like Charlie had entered into the contract as a pre-incorporation contract, SI could claim they were not bound if the corporation never ratified the contract or received the benefit of it. SI has been properly formed and the directors approved the contract so this defense is not available.

II. Charlie's Potential Breach of Duties to SI

As a director of SI, Charlie owes the corporation the fiduciary duty of loyalty which involves a duty to avoid usurping corporate opportunities. When a director learns of an opportunity based on his position as director (Charlie was approached by GP about "another" real estate project of theirs), he may not personally benefit from the knowledge by acting on the opportunity until he presents it to the corporation and allows the corporation to reject it. Here, Charlie will claim that he knew Al and Betty were unhappy with the earlier contract and that they wouldn't approve any further contracts with GP. However, Charlie's mere "belief" that the board would not approve further contracts does not absolve him of the duty to report the opportunity to them and wait for them to reject it. Considering the circumstances of SI's financial difficulties, they probably would have rejected it immediately and Charlie could proceed on the investment with his own money after fully and properly disclosing it to SI. Instead, Charlie never mentioned the project to anyone at SI, but went forward with investing his own money into the opportunity. Traditionally, the financial inability of the corporation to take advantage of the opportunity may have been an adequate defense to a director accused of usurping a corporate opportunity, but even if that was the case here, this defense is no longer a good one. Charlie breached his duty of loyalty.

The other fiduciary duty which Charlie owes SI, the duty of care, could also be potentially implicated in this situation if Charlie denied the GP smaller mall contract on behalf of SI and it would have been a good investment. The duty of care requires a director to act as a reasonably prudent person would in similar circumstances. As discussed above, Charlie should have presented the opportunity to SI's board and let them vote to refuse it. Given SI's financial struggles, it would have been a proper exercise of business judgment to decline the opportunity and a court would not question Al, Betty, or Charlie's decision to not enter the contract under the business judgment rule.

III. Removing Charlie from the Board of Directors

Betty and Al will attempt to oust Charlie from the Board of Directors on the theories that he breached his fiduciary duties. If they know about his usurpation of the opportunity to enter a contract with GP related to the smaller mall, they would be able to show that he breached his duty of loyalty. If he is, in fact, skimming corporate funds, then he is self-dealing, another violation of the duty of loyalty which exists when a director reaps personal advantage at the expense of the corporation. They would also argue that he breached his duty of care by acting unreasonably in his pursuit and advocacy of the new business direction of real estate development. A director has the responsibility of acting in the corporation's best interests as a reasonably prudent person would in the investments they make. Betty and Al would argue that the investment of a "substantial" amount of SI's capital into real estate development (especially given that their sole purpose is operating comedy clubs) would not escape scrutiny and condemnation, even under the business judgment rule. However, Al and Betty agreed to taking SI in that new direction and no matter how "heated" the discussions were, they eventually approved the decision.

Importantly, Betty and Al cannot oust Charlie from the Board of Directors by their own act because only shareholders can remove a director. Thus, Al and Betty would need to bring all of the information they have about Charlie's breaches of fiduciary duties and any other reasons they have to desire his removal to the shareholders and let the shareholders address the question. A majority vote of all shareholders would be required for Charlie's removal. Considering what appears to be bad financial judgment on Charlie's part, the obvious breaches of the duty of loyalty, and the fact that shareholders can remove a director with or without cause, the shareholders would probably vote to remove him and Al and Betty would succeed in their ousting, although indirectly.

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ESSAY QUESTIONS AND SELECTED ANSWERS
FEBRUARY 2010
CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the February 2010 California Bar Examination and two selected answers to each question.

The answers received good grades and were written by applicants who passed the examination. The answers were prepared by their authors, and were transcribed as submitted, except that minor corrections in spelling and punctuation were made for ease in reading. The answers are reproduced here with the consent of their authors.

Question 2

Able, Baker, and Charlie are successful attorneys who set up a law firm under the name "ABC Legal Services LLP" ("ABC LLP"). They agreed to share profits and losses equally. Able prepared the documents required to register the firm as a limited liability partnership and instructed his assistant to file them with the Secretary of State. Inadvertently and unbeknownst to Able, Baker, and Charlie, Able's assistant never filed the appropriate documents.

Able, Baker, and Charlie leased office space for four attorneys in the name of ABC LLP. They rented the extra office to David, an attorney who had a small solo law practice, for a monthly rent of the greater of $1100 or 10% of his billings. David committed malpractice arising from a case that he undertook soon after he moved into the ABC LLP office space.

Able, Baker, and Charlie hired Jack as head of computer services. Jack had just graduated from college with a degree in computer science. Jack, in an effort to save ABC LLP the cost of Internet access budgeted at $500 a month, accessed and used the wireless network of an adjacent law firm for free. Able, Baker, and Charlie were surprised at the savings, but did not inquire how it came about. Their use of the network resulted in the disclosure to a third party of confidential client information for one of Able's clients, which caused the client economic loss.

1. May Able, Baker, and Charlie each be held personally liable for the economic loss to Able's client caused by the disclosure of confidential client information? Discuss.

2. May Able, Baker, and Charlie each be held personally liable for David's malpractice? Discuss.

3. Have Able, Baker, and Charlie breached any rules of professional conduct? Discuss. Answer this question according to California and ABA authorities.

Answer A to Question 2

Limited Liability Partnerships:

The main benefit of an LLP is that the partners have limited liability – meaning that they are not personally liable for the debts and obligations of the partnership. To be properly formed, the LLP papers must be filed with the Secretary of State. Here, the ABC paperwork was not filed and the LLP was never registered. Without the proper paperwork, this venture is likely to be treated as a general partnership.

General Partnerships:

General Partnerships ("GP") are formed by two or more persons carrying on a business for profit. There are no filing requirements for forming a GP. GPs can be made up of general partners and limited partners. General partners have a duty to manage the business and can be held personally liable for partnership debts and/or obligations. Limited partners, however, are not liable for partnership debts and may lose their limited status if they engage in management. Absent any agreement each partner has an equal vote, profits are shared equally, and losses are shared as profits are.

A, B, and C are likely to be seen as general partners in a GP; thus they are entitled to an equal say in the management of the business and may be held personally liable for partnership debts.

Ethical Duties of Attorneys:

Attorneys owe a wide array of duties – to clients, the court, opposing counsel, and the public generally. The duties are established by ABA rules as well as state-specific rules. California's rules on ethical conduct of attorneys largely follows the ABA rules, but there are variances which will be noted if applicable below.

Duties to clients:

Attorneys owe clients the duties of confidentiality, loyalty, financial responsibility, and competence. Duties owed to the court and opposing counsel include the duties of

candor, fairness, and decorum. Attorneys must also ensure that all members of their firm, including staff, act in accordance with the ethical standards imposed. To the extent that one attorney has a conflict, such conflicts are imputed to the firm and are shared by all other attorneys unless the conflict arises from prior governmental work or a personal relationship with the opposing party's counsel, for example.

1. The disclosure of client information:

One of the most important duties owed to clients is the duty of confidentiality. This duty requires the attorney to act so as to not reveal any confidential information of the client – without consent, either express or implied. The facts do not indicate that any consent was given to the disclosure of this information in this case.

Here, the client information was revealed due to the use of an un secured wireless network which the firm used. Although the facts indicate that the attorneys were not aware of the use of the adjacent building's wireless network, we do know that they were surprised by the cost savings. If the attorneys were aware of unexpected savings, they should have spoken with Jack to determine why internet access was so much cheaper than expected. Because they did not so inquire, and consequently were unaware of the issue, Jack acted unethically by using another network for free. A, B, and C all had a duty to ensure that Jack's actions were proper and ethical.

Because ABC is likely to be deemed a GP, all general partners may be held liable for the debts of the firm. These debts can include the economic losses incurred from the disclosure of information and/or debts incurred if the client sues the firm for malpractice.

2. David's liability for malpractice:

Here the issue will be whether David is a partner of the firm or merely a lessee of an office. A, B, and C will argue that D was merely renting space from the firm, making him not a partner, and therefore not subjecting the firm to any liability for his actions. We do not have facts to indicate whether David ran his business under a separate name, kept his files in a separate room, used the same office staff, or contributed any money to the partnership. The first three factors would indicate a separate firm, while the final factor – buying into the partnership – would indicate that D had become a partner of ABC.

What we know is that David paid monthly rent. Absent other facts, paying rent indicates the D was likely a separate practitioner. If D was acting as a separate practitioner, the ABC firm partners would not be liable for this malpractice.

However, if there were facts to indicate the D was a partner of the firm, or that the malpractice occurred with regard to a firm client, the firm general partners may be liable for D's malpractice. In a LLP, as intended, partners are all liable only for their own malpractice, but in a GP, the general partners can be held liable for all partnership obligations. In a GP incoming partners are not liable for existing partnership debts, through the money they contribute can be used to pay off such debts. Outgoing partners of a partnership are liable for debts of the partnership until creditors have been given notice of their departure or 90 days have passed since their departure.

D's malpractice occurred shortly after he took up office space with ABC. If he were deemed to be a partner, and the malpractice occurred after joining the partnership, ABC general partners would be liable for partnership debts arising out of his malpractice.

3. Professional conduct:

The attorneys of ABC have violated a number of rules of professional conduct.

a. Management of Staff:

The attorneys have a duty to properly manage staff and ensure that all members of the firm are in compliance with the rules of conduct. Here, A gave partnership documents to an assistant for filing. While staff members of a firm frequently are in charge of filing court documents or making deliveries, it was likely imprudent to allow such an important document to be handled by an assistant. Because of the assistant's negligence the firm likely lost its privileges as an LLP. Attorneys cannot allow the unauthorized practice of law by non-attorneys. Here the documents likely did not need to be filed by an attorney, but the task was nonetheless important enough that it should have been done by a partner so as to ensure accuracy.

The attorneys were prudent in hiring Jack as a computer services manager as he was properly qualified with a degree in computer science. The use of non-attorneys does

not violate any ethical rules so long as fee sharing does not occur (payment of non-attorney salaries is not considered fee sharing.) The attorneys likely violated their ethical duties in their management of Jack, however. By not managing Jack properly and being unaware of Jack's use of an unsecured wireless network, A, B, and C breached not only their duties as managers, but also their duty of confidentiality to their client.

b. Duties to clients:

Attorneys owe their clients the duty of confidentiality – the duty to not reveal any confidential information without consent. Information may be revealed where necessary to defend oneself against a claim of malpractice or potentially if the attorney knows of conduct which will result in death or serious bodily harm which can be prevented through disclosure. The CA rules indicate that the conduct must be criminal; however the ABA makes no such distinction. Here, the requisite facts for proper revelation of client information do not appear. ABC breached its duty of confidentiality to its client by allowing the transmission of client information to a third party.

Attorneys also owe clients the duty of loyalty, which prevents attorneys from taking on representation or taking actions which are in conflict with current clients. Attorneys must always act in the best interests of their clients and with their interests at heart. It is unclear to whom the confidential information was revealed, but the ABC firm may have breached their duties of loyalty as well if the use of the network resulted in revelation of information to an adverse party.

Financial responsibility imposes on an attorney the duty to properly manage client funds and avoid commingling personal money. There are no facts indicting a breach of this duty by ABC.

The duty of competence requires that attorneys provide clients with professional, skilled, competent services. Here, by use of an unknown wireless server which allowed for the disclosure of confidential information, the attorneys of ABC have acted competently. A competent attorney would have ensured that information was not revealed, and would have properly managed all staff members.

Answer B to Question 2

Liability for Loss Due to disclosure of confidential information:

A partnership is an association of persons to carry on a business as coowners for profit. The partners are jointly and severally liable for the debts of the partnership, both in contract and in tort. A limited liability partnership is a partnership that registers as an LLP with the Secretary of State. As an LLP, the partners are liable for their own torts incurred in furtherance of the partnership but not for the torts of the other partners or the partnership.

Filing the documents to register the partnership as an LLP is a prerequisite to attaining limited liability status. By not doing so the partnership retains the status of a general partnership and, therefore the partners would be personally liable for all liabilities of the partnership to the extent the debt was not satisfied by the partnership.

They could argue they intended to be an LLP and treated themselves as such, so they should be deemed to be a "de facto LLP." However, this argument is likely to fail because filing is such a simple act and the "de facto" argument has been applied in the corporation, not the partnership contract. Also, an LLP by estoppel argument would fail because there are no facts to indicate Abel's client thought he was dealing with an LLP, and, even if he did believe that, this defense would not apply to a loss caused by a tort – i.e., negligence.

As partners A, B, and C are liable for failing to properly supervise Jack. Jack was their employee. His tapping into a wireless network directly caused the disclosure of client information. As his employee A, B, and C Legal Services is vicariously liable for the torts of their employee. Here Jack committed the intentional tort of conversion, the intentional taking of the personal property of another. He did this while working for the ABC LLP and with the intent of furthering their business. Therefore, even though the tort was intentional, ABC LLP is liable. Further they could be found liable for negligently hiring an inexperienced computer person and then failing to adequately supervise him. See the discussion of their failure to supervise and prevent breach of confidentiality

rules infra. Violating the rules does not show a personal liability but is evidence they breached their standard of care. Since ABC LLP is liable, the partners are jointly and severally liable for reasons discussed above.

David's Malpractice

A partnership is defined above. In order to prove the existence of a partnership, the primary element is whether the parties intend to share profits. Other indications are whether they share in losses and share in the management of the enterprise.

In this case David leased an office for a monthly rent that included 10% of his billings. While that relates to David's profits, it does not represent a sharing of profits because the amount is received as rent under a landlord-tenant relationship. Moreover, there is no indication of any sharing of losses or management responsibilities. There is no partnership between David and A, B, or C. Likewise, there is no indication that David otherwise held himself out as a partner of A, B, and C. One can be deemed to be a partner if he is deemed to have apparent authority by being held out as a partner. Since that is not the case here, ABC LLP is not liable for David's malpractice, and therefore ABC or its partners are not liable.

Breach of Rules of Professional Conduct

Lawyers have a duty to preserve the confidentiality of confidential client information. It may only be disclosed if expressly or impliedly authorized by client or permitted by the rules of professional conduct. None of the exceptions are relevant here, such as to present a crime involving death or serious bodily harm, serious economic loss (ABA rules only) or in response to a court order or order of the ethics committee.

Partners in a law firm have an obligation to put in place procedures to assure compliance with the rules of professional conduct.

They also have a responsibility to take any action to prevent or mitigate violation of the rules if they are able to do so.

Here ABC did not adequately supervise Jack or have any procedures in place to prevent violations of the confidentiality rule, resulting in a breach of the confidentiality rules. They breached the rules and may be disciplined accordingly.

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ESSAY QUESTIONS AND SELECTED ANSWERS
JULY 2010
CALIFORNIA BAR EXAMINATION

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Question 4

Alfred, Beth, and Charles orally agreed to start ABC Computers ("ABC"), a business to manufacture and sell computers. Alfred contributed $100,000 to ABC, stating to Beth and Charles that he wanted to limit his liability to that amount. Beth, who had technical expertise, contributed $50,000 to ABC. Charles contributed no money to ABC but agreed to act as salesperson. Alfred, Beth, and Charles agreed that Beth would be responsible for designing the computers, and that Charles alone would handle all computer sales.

ABC opened and quickly became successful, primarily due to Charles' effective sales techniques.

Subsequently, without the knowledge or consent of Alfred or Charles, Beth entered into a written sales contract in ABC's name with Deco, Inc. ("Deco") to sell computers manufactured by ABC at a price that was extremely favorable to Deco. Beth's sister owned Deco. When Alfred and Charles became aware of the contract, they contacted Deco and informed it that Beth had no authority to enter into sales contracts, and that ABC could not profitably sell computers at the price agreed to by Beth. ABC refused to deliver the computers, and Deco sued ABC for breach of contract.

Thereafter, Alfred became concerned about how Beth and Charles were managing ABC. He contacted Zeta, Inc. ("Zeta"), ABC's components supplier. He told Zeta's president, "Don't allow Charles to order components; he's not our technical person. That's Beth's job."

Charles later placed an order for several expensive components with Zeta. ABC refused to pay for the components, and Zeta sued ABC for breach of contract.

Not long afterwards, ABC went out of business, owing its creditors over $500,000.

1. How should ABC's debt be allocated? Discuss.

2. Is Deco likely to succeed in its lawsuit against ABC? Discuss.

3. Is Zeta likely to succeed in its lawsuit against ABC? Discuss.

Answer A to Question 4

1. How should ABC's Debt be Allocated?

To begin, one must determine the nature of the organization that was created. In this instance, there were no formalities or written arrangements to begin a business with Alfred (A), Beth (B), and Charles (C). Corporations require formal articles of organization to be filed with the state. In this instance, it is much more likely that a partnership existed. No formalities are required to form a partnership. Partnerships exist when two or more people agree to carry on a business for profit. In this case, ABC was formed to sell computer items for profit. Generally, partnerships are also presumed if there is an agreement to share profits equally. In this instance, there is no indication as to what profit sharing arrangement existed, if any at all. As such, the default rule is that this would be a partnership with equal sharing of profits. Furthermore, without an express agreement as to how losses will be shared, the default is that they will be shared just as the profits are shared. Therefore, losses will also be shared equally. The amount of capital contribution by each partner is irrelevant to this equation.

A will argue that he expressed a desire to limit this liability. However, absent a formal agreement and filing of the proper limited liability forms with the state (articles of organization and an operating agreement) for a Limited Liability Company, A is going to be considered a general partner. This is further indicated by his general managerial position, apparent equal voting rights, and active management in the company. A was the one to call Zeta (Z) and tell them not to accept orders from C. This indicates his active management. Limited partners, those with limited liability, generally have no managerial functions. Given there is no formal limited liability structure or arrangement, and given the various management positions by each person, they are all general partners who will share equally in the profits and losses of the business.

On top of profit and loss sharing, each general partner is liable for the debts of the entire partnership. Each partner is considered an agent of the partnership. Under agency law, any contract or tort entered into in the scope of the partnership is deemed to be partnership debt, and all partners are jointly and severally liable. As such, any of the following contracts that were properly entered into and authorized by a partner having

authority are partnership debts that A, B and C will be jointly and severally liable for as individuals.

In the event that the copy is forced to liquidate and pay, the order of payment is as follows. First, the company must pay all debt creditors first. Second, the company must pay back all capital contributions from each partner, which would be $100,000 to A and $50,000 to B. While C may argue that his contribution was in sales, partners generally have no right to salary or compensation for services unless they are winding up. As such, C is not entitled to this amount as a capital contribution absent any other agreement. Finally, any remaining loss or profit would be distributed as applicable, which is equally in this case.

2. Is Deco likely to Succeed in its Lawsuit against ABC?

Validity of the Agreement

In order to prevail Deco (D) must show that B was authorized to enter the contract. In general, all partners are authorized as agents. However, the nature of their authority may vary. Express authority exists when the arrangement expressly states what an agent may do. Here, there is no indication that B was told to enter into a sales contract. In fact, sales were expressly reserved to C. Implied authority exists when the function is 1) necessary to carry out other responsibilities, 2) one that has been done in the past dealings without object[ion], or 3) normal custom for someone with the position of the agent. Here, sales are not necessary to B's technical design responsibilities, and she has never sold before. However, D could argue that a general partner in a business customarily has authority to enter contracts. Still, the express reservation of the right to likely kills this argument. Finally, D may argue apparent authority. This exists when the company cloaks the agent with authority to do certain things and later withdraws or limits that authority without notifying a customer who is still relying on that authority. In this case, there is no indication that ABC held B out to be a sales representative in the first instance. There was likely no good basis that D had to rely on any authority from ABC. However, given that B herself is a managing partner, D likely could argue that B's actions were sufficient to show that the corporation had given her authority to act. As such, they will argue that it was reasonable to rely on this without any other notice. This would bind ABC. Failing to perform on the contract is a breach of duty and the

partnership, as well as the individual partners, will be obligated to pay as described above.

Breach of Duty of Good Faith and Loyalty

Partners have fiduciary duties to each other that are described as the utmost duty of good faith and loyalty. Under the duty of loyalty, a partner must not engage in self-dealing, usurping business opportunities, or competing against the company. In this instance, B engaged in a transaction with her sister who owned D. The terms were apparently very favorable to D. This could be viewed as self-dealing because it promoted B's familial interest with her sister and was not in the best interest of the company. The duty of good faith requires that partners act in a way that solely benefits and is advantageous to the partnership. Again, B's deal with D didn't garner the profits that it should have. Furthermore, this duty requires disclosure of conflicts of interest to the other non-interested partners so that they can either cleanse the transaction through ratification or disapprove it. There is no indication that B informed her partners. The other partners have a very strong argument to bring a claim against B for these breaches in duty. This would place the entire liability for the breached contract on B, which would deviate from the normal liability scheme described above.

3. Is Zeta likely to Succeed in its Lawsuit against ABC?

Validity of the Agreement

Zeta's (Z) claim on this contract again hinges on the authority of C to enter into it. In this instance, C has the express authority to enter into sales contracts. However, this contract was for components being purchased by C, which is outside his express authority. Z may argue that components are necessary to production and later sales, which gives C implied authority to enter into contracts. Plus, it is reasonable to assume that a partner who can sell can also buy. This also lends credence to a claim of apparent authority. Z will argue that ABC has held C out as a person whose sole responsibility is to contract, and it reasonably relied on that representation. Z's main issue is that A called and gave actual notice that C could not enter into this contract. This would destroy any reasonable reliance that Z had. A told Z that B was the technical person, not C. As such, Z should have seen that his was outside the scope of C's authority.

Notwithstanding the arguments above, C is still a general partner in the company. If Z is at all knowledgeable about agency law and partnerships, Z could rightly assume that one partner doesn't have the sole authority to terminate the management authority of another partner. Management functions are only transferable and alterable upon a unanimous vote of the partnership. In this case, A alone tried to limit what C could do. Z may argue that it knew this wasn't a proper action by A and more reasonably relied on C. In the end, I think it is likely that the court would find that Z at least should have investigated further once given notice that C may not have authority, and failure to follow through made there [sic] reliance on his apparent authority unreasonable. As such, this contract is invalid and will not bind ABC. Should the court disagree, any resulting contract liability would be distributed among the partnership and A, B and C as described above.

Effect of A's Notice on C's Duties

A might also claim that C's activities outside his scope of duty were not in good faith. There is no indication that loyalty of fair dealings are implicated. So far as we know, the contract with Z could have been completely advantageous and proper. However, the argument is that acting in an area in which C knows nothing about shows a lack of obedience to his agency limits and lack of good faith in honoring partnership agreements on authority. However, nothing in C's behavior indicates an improper motive. This is a young startup with new partners. It is unlikely that C thought he was doing anything wrong. Rather, it is reasonable to assume he thought he was helping out in another area. Also, A didn't act with the consent of B. As such, there is no indication that the majority of management is at odds with C's decision to enter the contract. This appears to be solely the reservation of A with B and C. In the end, there was likely no breach of duty and any potential liability from this contract would flow to all, not just C.

Answer B to Question 4

1.) How should ABC's Debt be Allocated?

The preliminary issue to determine is what type of business was formed when Alfred (A), Beth (B), and Charles (C) agreed to start ABC computers.

Formation of a General Partnership

A general partnership is formed when two or more people agree to run a business for profit, contribute funds or services in exchange for a share of the profits. Unlike a limited liability corporation or limited partnership, a general partnership requires no formal paperwork to be filed with the secretary of state. If the above definition of a general paratnership is met, then the business will be presumed to operate like a general partnership. Here, A,B, and C agreed orally to start ABC computers and did not file any corporate or partnership paperwork with the state. A contributed $100,000, B contributed $50,000 and her technical expertise and C contributed his services as a salesperson. They distributed the work amongst themselves. Although the facts do not state that they shared in the profits, it can be assumed that they shared in the profits because ABC becomes successful. Thus, because no formal paperwork was filed, all three members contributed money or services and share in the profits, there is a presumption that ABC operated as a general partnership.

Characteristics of a General Partnership

General Liability

In a general partnership, all partnerships share equally in liability and are personally liable for the debts of of the other partners and the partnership. Although A stated that he wanted to limit his liability, there are no facts to support that this was actually accomplished through an agreement, contract or that the partnership filed for a limited liability partnership. The only way that A could limit his liability would be to become a limited partnership, but that can only be done if the proper paperwork is filed with the state; there is at least one limited partner and at least one general partner. Because there is an absence of the necessary components of a limited liability partnership, A's liability will not be limited.

Each Partner is a Fiduciary and Agent to the General Partners and Partnership

Each partner is a fiduciary and agent to the general partnership and general partners. Thus, the laws of agency apply to the partners when acting in furtherance of and conducting business for the partnership.

Default Rules for General Partnership

In absence of an agreement governing the partnership, the default rules of partnership will be applied by the court. Here, A, B, C only had an oral agreement about how to run the business and not formal structure or governing documents for the partnership. Thus, the default rules will be applied.

Several of the key default rules that are applicable in the present situation include: Each partner has equal power to manage the partnership; when there are profits they are shared equally and losses are shared like profits.

Dissolution of General Partnership

Upon dissolution of a general partnership, there is a specific order in which assets must be distributed. First, creditors must be paid and general partners who loaned money to the partnership. Second in line to [be] paid are general partners who made capital contributions. Lastly, any surplus or profits will go to the general partners or the general partners may be personally liable for existing debt of a dissolved corporation. Partners who contributed capital contributions and made loans to the company should receive their money back if it is possible upon dissolution.

Here, ABC went [out] of business and owed its creditors over $500,000. It is unclear how much profit was made or the assets of the partnership at the time it went out of business. Assuming the partnership went out of business due to lack of profits or funds, then the creditors are to [be] paid all that was left of the partnership's assets and each general partner will be personally liable for the remaining that is owed to the creditors. As discussed above, although A wanted to limit his liability, that is not done properly, so each partner will be equally liable for the debt after all partnership assets have been used to pay the creditors and there remains a debt stilled owed to the creditors.

2.) Is Deco likely to Succeed in Lawsuit against ABC?

Here, B as a general partner of ABC entered into a written sales contract with Deco, Inc. The contract was extremely favorable to Deco and not ABC. Deco was owned by B's sister. When A and C learned of the agreement with Deco they informed Deco that B had no authority to enter into sales contracts and that ABC could not profit if it sold computers at that price. ABC refused to deliver the computers and Deco sued. The issues are whether B can bind the partnership and whether A and C can cancel the contract that B made.

B's Authority to Enter Into Agreements that Bind the General Partnership

Absent an agreement, the default rules of partnership state that each general partner has an equal right to manage the partnership and act as agents for the partnership in the usual course of business. This means that the general partners have authority to enter into contracts that bind the corporation as long as the contracts are in the regular course of business of the partnership. The other partners do not need to assent to know about the agreement, but will become liable on any agreement that is validly entered into by one of the other partners in the course of business. Here, A, B, and C agreed that B would be responsible for designing computers and C alone would handle computer sales. Although they delegated responsibility for tasks, there is no agreement that limited authority of any of the partners; thus the default rules apply (although one could argue that their delegations of tasks was akin to agreement to limit authority, but the mere oral agreement is not sufficient to rise to a degree of limited partnership rights). Therefore, B can enter into contracts in the regular course of business the bind the general partnership without the knowledge or consent of either A or C. Thus, it was proper for B to use her authority as a general partner to enter into an agreement with Deco to sell computers to Deco.

B's Fiduciary Duties of General Partners and Partnership

However, every general partner owes a duty to the partnership and general partners. Each partner must act as a fiduciary, owing a duty of care and loyalty to the general partnership. Each partner has a duty of lolyalty to the corporation to do [sic] not compete with the partnership, usurp the partnership's opportunities or engage in any

self-dealing where the paratner receives a benefit to the detriment of the corporation. Here, B entered into a contract with Deco, which was owned by her sister. Inherently, there is nothing outrightly wrong with entering into an agreement with a family member. However, the contract that B entered into with her sister was extremely favorable to her sister and would actually cause ABC not to profit. Thus, the agreement was extremely beneficial to Deco, and B's sister, to the detriment of the partnership. Therefore, B's actions can be characterized as self-dealing because her sister received a benefit to the detriment of the partnership. Thus, B breached her duty of loyalty to the partnership.

When a partner breaches a duty of loyalty, the profits can be disgorged and the contract can be revoked or rescinded. Here, because B breached her duty of loyalty to the partnership in forming the contract with her sister, the contract can be revoked. Further, a court would likely allow the contract to be revoked. Because B's sister was a wrongdoer because [she] was well aware of B's positon and responsibility/duty to the general partnership, B's sister cannot claim that she was innocent and did not know that her sister owed a fiduciary duty to the corporation.

Thus, although B had authority to enter into the contract with Deco, because B breached her duty of loyalty to ABC, ABC can refuse to deliver the computers under the contract and hold B personally liable for damages.

3.) Is Zeta likely to Succeed in Lawsuit against ABC?

Here, A contacted Zeta, Inc., a supplier of components for ABC, and told the President to not allow C to order components because that was B's job. Then C placed an order with Zeta and ABC refused to pay for components. Zeta, Inc. then sued ABC. The issues are whether A can limit C's power and whether after informing Zeta that C should not be allowed to place orders, whether ABC can refuse to pay for the components ordered by C.

A's Authority to Revoke C's Authority

As discussed above, in absence of an agreement the default partnership rules apply. In the present case, ABC has no formal agreement and thus each partner will share equally in the management duties. Additionally, each manager has the authority to bind

the partnership. Here, A and C have equal management power and power to bind the coporation. The issue is whether A has the authority to revoke C's power and authority absent any agreeement.

A does not have authority to revoke C's power and authority to enter into contracts simply because he is concerned about how B and C were managing the corporation. There was no agreement as to what A was responsible for. In light of the fact that no partner was given a power similar to that of a CEO or oversight or management of the entire partnership and other partners' action, A had no authority to revoke C's authority.

Further if A was under the impression that he was [a] limited partner, he would not be allowed to engage in managing the partnership under the traditional limited liability partnership model. Under the traditional limited liability partnership model, limited partners have limited liability and cannot engage in management of the partnership. If limited partners engage in management of the partnership, then they forfeit their limited liability status. However, under the newly revised Uniform Partnership Code, if it applies in this jx, limited partners may retain their liability and manage the partnership.

Although A had no power to revoke C's authority, the president of Zeta was put on notice that A did not want C to have the ability to bind the partnership due to how management powers/oversight was delegated. Thus, the president of Zeta should have thought twice before entering into an agreement with C, because at the very minimum with such informtion Zeta's president should have known that there was some conflict over management powers or personal issues between C and A. It was irresponsible of Zeta's president to enter into the contract with C after receiving such information from A.

C had authority to enter into the agreement with Zeta because C's authority was not limited in any way. Thus, although Zeta was aware that he could potentially have problems with the contract, the contract was validly entered into by C (assuming all contract formalties were met). Thus, the partnership and all the partners will be personally liable for breach of contract to Zeta.

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ESSAY QUESTIONS AND SELECTED ANSWERS
FEBRUARY 2011
CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the February 2011 California Bar Examination and two selected answers to each question.

The answers received good grades and were written by applicants who passed the examination. The answers were prepared by their authors, and were transcribed as submitted, except that minor corrections in spelling and punctuation were made for ease in reading. The answers are reproduced here with the consent of their authors.

Question 5

Bob owns 51 percent of the shares of Corp., a California corporation. Cate owns 30 percent. Others own the remaining shares.

Bob and Cate have entered into a shareholder agreement stating they would vote their shares together on all matters, and that, if they fail to agree, Dave will arbitrate their dispute and Dave's decision will be binding. Bob and Cate also executed perpetual irrevocable proxies granting Dave the power to vote their shares in accordance with the terms of the shareholder agreement. Attorney Al handled Corp.'s incorporation and drafted the shareholder agreement and the proxies.

Bob and Cate have been able to elect the entire board of directors every year. The board currently consists of Bob, Cate, and Bob's wife, Wanda. Bob and Wanda decided, as directors, to sell substantially all of Corp.'s assets to Bob's sister, Sally. Cate thinks the price is too low. Bob claims he no longer regards their shareholder agreement as binding. He has gone to Al for advice in the matter, and Al has agreed to provide it.

At the shareholders' meeting at which the matter is to be put to a vote, Bob announces he is voting his shares in favor of the sale. Dave says that since Bob and Cate disagree, he is voting the shares against the sale.

1. Is the shareholder agreement between Bob and Cate enforceable? Discuss.

2. Are the perpetual proxies executed by Bob and Cate enforceable? Discuss.

3. Would any sale of Corp.'s assets to Sally be voidable? Discuss.

4. What ethical violations, if any, has Al committed? Discuss. Answer according to California and ABA authorities.

Answer A to Question 5

1. Shareholder agreement between Bob (B) and Cate (C)

A shareholder's agreement is an agreement whereby shareholders agree to combine their votes for voting matters related to their rights as shareholders. The agreement is less formal than a voting trust and requires simply that the shareholders agree to the course of action. Where a voting trust is required to notify the Secretary of the Corp. the shareholder agreement need not be recorded by the Secretary. In addition, where a voting trust is only good for 10 years, a shareholder agreement has no durational requirement.

In this case, B and C have entered into a shareholder agreement stating they would vote their shares in agreement or else submit to Dave to arbitrate any disputes. Dave's decision would be binding. While B and C have entered into a valid shareholder agreement, as they can agree to arbitration to settle disputes, it is necessary to look at Dave in this instance.

It is not clear what, if any, relation Dave has to the corporation. If Dave is familiar with the corporation, then there would be no issues with him arbitrating disputes. If he is a true "outsider" he may not have the knowledge and ability to make the informed decisions in the corp's best interest. In this case, B and C would violate their fiduciary duties to the corp. and the agreement would be ineffective.

2. Perpetual Proxies

A proxy is an agreement between shareholders to have one vote on their behalf. The corp. must be notified and a proxy is valid for 11 months, unless otherwise agreed. An irrevocable proxy requires that the proxy be labeled irrevocable and must be coupled with an interest.

In this case, the proxies are perpetual and irrevocable. As stated above, an irrevocable proxy must be labeled such and be coupled with an interest. It is not clear here what, if any, interest Dave received as part of the proxy agreement, or if the proxies were

labeled irrevocable. If neither requirement was met, the irrevocable proxies would be unenforceable.

If both conditions were satisfied, it would be necessary to determine if the corp. was notified. In addition, proxies typically last for only 11 months. Because the facts state this is perpetual, it is likely that the courts would find this unenforceable.

3. Sale of Corp. Assets

Directors have a duty to manage a corporation. Directors also have fiduciary duties of Care and Loyalty in managing the corporation. Directors may be insulated from violating the duty of care by the Business Judgment Rule.

Duty of Care

Directors have a duty to manage a corporation as a reasonably prudent person would in handling his/her own affairs. Directors must act in the best interest of the corporation.

Here, it is not clear from the facts if Bob and Wanda, as directors, are acting in good faith as reasonably prudent persons would in their own affairs.

Business Judgment Rule

Directors are protected from liability under the Business Judgment Rule when they act in the corp.'s best interest and make a reasonable, innocent mistake.

Here, because it is not clear if Bob and Wanda acted in good faith, it is not possible to determine if this is a simple mistake.

Duty of Loyalty

A director has a duty of loyalty to his corporation, which means that without full disclosure and independent ratification, a director cannot engage in a self-dealing transaction or usurp a corporate opportunity.

In this case, Bob and Wanda, as directors, have voted to sell substantially all assets to Sally, who is Bob's sister. A self-dealing transaction is one that benefits the director or his family members. In order for the transaction to be valid, there must be independent ratification, as defined above. It would be impossible to obtain independent ratification as 2 out of the 3 Directors will not be independent. Both Bob and Wanda, Bob's wife, stand to benefit from the self-dealing transaction, and it does not appear that there was full disclosure, so independent ratification is impossible.

Controlling Shareholders

Controlling shareholders have fiduciary duties to other shareholders in a corporation. As defined above, the controlling shareholder has a duty of loyalty and care as fiduciary duties.

As described above, Bob will have violated his fiduciary duty of loyalty to the corp. by engaging in a self-dealing transaction. In addition, courts have held controlling shareholders liable for looting a corporation in the event the corp. is substantially sold to a 3rd party and that party loots the company. It is not clear here what Sally will do.

Fundamental Change

A corporation must hold a special meeting when a fundamental change is proposed for that corporation. A fundamental change would include selling substantially all assets to another corporation. Therefore, the corporation would be required to have a special meeting.

A special meeting requires that a special notice be mailed to shareholders. This notice must include the reason for the special meeting, date and time, and place. It is important because no other business can be discussed at a special meeting that was not included in the notice. In addition, holding the meeting is important because it gives rise to appraisal and dissenter rights whereby the corporation would be required to repurchase a dissenter's shares.

Because Bob violated his fiduciary duties as a director and controlling shareholder, and because the corp. was undergoing a fundamental change without a properly scheduled special meeting, any sale to Sally would be voidable.

4. Ethical Violations

A. Duty of Loyalty

Al owes a duty of loyalty to the corporation. Al has drafted the incorporation of the corp. and has drafted agreements on behalf of the corporation. Therefore, Al's client is the corporation.

Al has a potential conflict in that he represented the corporation and then drafted the shareholder agreement and proxy on behalf of 2 shareholders. This is permissible under ABA rules and CA rules whereby an attorney can represent multiple parties if he reasonably believes that he can provide necessary legal services without impact. The attorney must also get this consent in writing.

Al has another potential conflict by representing Bob at a later time. As stated above, an attorney can represent multiple parties if he reasonably believes that representation of both will not impact either party. He must get consent in writing. Al would have violated his duty of loyalty if he did not get consent in writing.

This potential conflict would become an actual conflict when Bob has gone to Al for advice and Al agreed to provide it. Al previously represented Bob and Cate in drafting a shareholder agreement and proxies. CA Rules of Ethics strictly prohibits an attorney from representing a client when that client is being represented by the same attorney. Only when the matter ends can the attorney represent another client whose interest is adverse to a current client.

Al will have violated his duty of loyalty.

Duty of Confidentiality

An attorney has a duty to keep all communications with a client confidential. When an attorney represents 2 parties, and one party then approaches the attorney for representation on a similar matter, the attorney will not be able to represent the client because he has confidential information from both clients.

Here, Al arguably represents both parties, as he has drafted a shareholder agreement and proxy for both Bob and Cate. Al should advise both parties to obtain separate Legal Counsel instead of continuing to represent them, as by doing so, he may disclose confidential information received by Cate in representing Bob.

Duty of Competence

An attorney should have the skill and training to be able to competently represent a client. If not the attorney should be able to receive such training in a reasonable time.

In this case, as described above, it is not clear if the proxies were drafted correctly; therefore Al may have breached his duty of competence.

Answer B to Question 5

SHAREHOLDER AGREEMENT

Shareholder agreements in which shareholders agree to vote their shares together are valid, although historically they were not permitted and voting trusts were required. They must be in writing and signed by both parties. Shareholder agreements are governed by regular contract principles, and are not revocable unless as a contract they would be revocable. A valid contract requires mutual assent and consideration. Bilateral contracts are contracts in which the parties exchange promises, and the promises can constitute consideration for the contract.

In this case, the shareholder agreement appears to be in writing, and signed by the parties. It was prepared by an attorney, Al, and so presumably has been validly drafted. In this case, the shareholder agreement is a mutual agreement for Bob and Cate to vote stocks together. It appears that there has been valid mutual assent to the contract, including offer and acceptance. Because the parties have exchanged promises to vote together, it is a bilateral contract. As a result, the contract is supported by consideration based on the exchange of mutual promises to vote together or have disputes decided by arbitration. Thus, Bob would be unable to revoke the shareholder agreement at will, and Cate could sue for damages or for specific enforcement of the agreement.

PERPETUAL PROXIES

PROXY GENERALLY - A proxy agreement must be in (1) writing, (2) signed by the party whose shares are affected, (3) addressed and delivered to the corporation's secretary, (4) clearly state they are delegating the authority to vote.

In this case, it appears that the requirements for a valid proxy agreement have been met. The agreement appears to be in writing, the problem notes it was executed so presumably is signed, it clearly states the procedures for the proxy, indicating that the

shares will be voted in line with the shareholder agreement. Although the facts do not indicate whether the proxy was filed with the corporation, because Al the attorney assisted, presumably the requirement was met.

IRREVOCABLE PROXY - A proxy is normally for a duration of 11 months, and will be revocable at will. To be irrevocable, a proxy must be (1) supported by an interest and (2) clearly state it is irrevocable.

In this case, it appears that the proxy agreement did state that it was irrevocable, and thus the agreement has met the second requirement. However, there is no indication that the agreement was supported by any interest. Normally, the interest must be some exchange for value or, for example, a situation where the record date holder sells his shares to the owner and executes a proxy, and thus the new owner's purchase creates an interest. In this case, there is no interest to support the agreement. Cate may argue that the exchange of promises provides consideration for the proxy in the form of the mutual promises, as was the case for the shareholder agreement, and therefore that the mutual promise is a sufficient interest to meet the element and make the proxy irrevocable. However, the exchange of promises is not a sufficient interest to support a proxy as being irrevocable because the promisor has no interest in the shares to which she is making a promise, and therefore this element has not been met. As a result, Bob is free to revoke the proxy agreement at will.

While the proxy agreement would be revocable because it is not supported by an interest, the shareholder voting agreement would not be. As a result, Cate could sue Bob to enforce the agreement and then Dave would have the power as the arbitrator to vote the shares under the agreement as he saw fit.

WOULD SALE OF CORP BE VOIDABLE

FUNDAMENTAL CORPORATE CHANGE - A fundamental corporate change includes a (1) merger, (2) consolidation, (3) amendment of the articles of incorporation, or (4) a

sale of all or substantially all of the business assets. A fundamental corporate change must be approved by a majority of all shareholders at a special noticed meeting in which notice of the change was given before the meeting. Additionally, the corporation must give dissenters rights of appraisal if the transaction is approved.

In this case, the sale of substantially all of Corp.'s assets is a fundamental change and thus must be approved by a majority of all shareholders in Corp.

DECISION OF DIRECTORS - All decisions of directors must either (1) be approved at a board meeting or (2) be approved by unanimous written agreement of the board. At a board meeting the majority of all directors must be present to have a quorum. A resolution will be adopted if a majority of the directors present approve. Before a fundamental corporate change is brought before a special meeting of shareholders, it must be approved by the board of directors.

In this case, the facts indicate that Bob and Wendy agreed to the sale, but that Cate disagreed. It is unclear if they met at a board meeting and the majority of directors, Bob and Wendy, approved. This would be a requirement that if not met, could lead to a rescinding of the transaction or allow Cate and other shareholders to sue Bob and Wendy for losses suffered as a result of the transaction.

DUTY OF LOYALTY OF DIRECTORS - A Director has a fiduciary duty of loyalty to a corporation to not engage in self-dealing or usurp business opportunities. Self-dealing includes transactions in which the director has a conflict of interest.

In this case, Bob is a member of the board of Corp, and thus has a duty to not engage in self-dealing.

CONFLICT OF INTEREST TRANSACTION - A conflict of interest transaction is one in which the director or his close relative is (1) a party to the transaction, (2) has a financial interest so closely linked to the transaction that would reasonably be expected to affect

her judgment, or (3) is a director, officer, employee or agent of the other party to the transaction and the transaction is of such importance that it would normally be brought before the board. If a Director enters into a transaction in which he has a conflict of interest without approval, that transaction can be rescinded and the director can be held liable for any losses to the shareholders.

In this case, Bob is engaging in a sale of Corp's assets to Sally, Bob's sister. Thus Bob, a director, is engaged in a transaction in which a close relative, his sister Sally, is a party to the transaction, and therefore Bob would have a conflict of interest in the transaction. Thus, unless Bob has the transaction approved, it could be rescinded. Furthermore, because Wanda is also a director, and Sally is also a close relative of hers, her husband Bob's sister, she would also have a conflict of interest.

CONFLICT APPROVAL - A conflict of interest transaction will be considered approved if (1) after full disclosure a majority of the disinterested directors, if more than one, approve; (2) after full disclosure a majority of disinterested shareholders approve; and (3) if it is fair under the circumstances.

DISINTERESTED SHAREHOLDERS - In this case, it is unclear if Bob fully disclosed. Even if he did, the transaction would not be considered to be approved by shareholders if Bob used his 51% of shares to approve the sale because he is not disinterested due to his conflict of interest created by his sister, Sally, being the purchaser. Thus, a majority of the outstanding, the remaining 49% would need to approve. Because Cate owns 30% of the shares, she could essentially block the transaction because she owns more than 50% of the disinterested shares. Thus approval by disinterested shareholders would not be possible.

DISINTERESTED DIRECTORS - Similarly, both Wanda and Bob are considered to have a conflict of interest. Therefore the only disinterested director is Cate. Cate would not approve the transaction and furthermore, for a transaction to be approved by the majority of disinterested directors there must be more than one disinterested director.

Thus, the directors could not approve the transaction because 2 of the 3, Bob and Wanda, are not disinterested.

FAIR - As a result, the only way the transaction could be upheld is if under the circumstances at the time it was entered into it was fair. In this case, Cate claims that the price is too low, but there is no indication if this is really the case. If Bob could show that the price was fair, and thus the transaction was fair then the conflict of interest transaction would be upheld despite the lack of approval from disinterested shareholders and directors.

ACTING AS SHAREHOLDER NOT DIRECTOR - Bob may argue that in voting to approve the sale he is acting as a shareholder, and not as a director and thus does not owe the same duties to the corporation. However, this argument will fail because (1) a director has a duty of loyalty to the corporation even when selling his own shares, and (2) Bob may also have a duty as controlling shareholder.

DUTY OF CONTROLLING SHAREHOLDER - While a shareholder is normally not liable beyond the value of their shares, a controlling shareholder may be liable towards other shareholders if she uses her power in a way to disadvantage the minority shareholders. This is because a controlling shareholder has a fiduciary duty to minority shareholders to not use their controlling share to the minorities' disadvantage.

In this case, because Bob owns 51% of the shares, he is a controlling shareholder. He has a fiduciary duty to not use his controlling share to gain unfair advantage over the minority shareholders. This would likely include selling substantially all of Corp.'s resources to his own sister, Sally, if the price was not fair. Thus, even if Bob is successful in arguing that he is not under a duty as a director when trading on his shares, as a controlling shareholder he would still be liable for breaching his fiduciary duty.

AL'S VIOLATIONS

DRAFTING ARTICLES AND SHAREHOLDER AGREEMENTS - When an attorney represents a corporation, he represents the organization itself and not the directors or officers. While an attorney may also represent the directors and officers separately, these representations are governed by normal rules of conflict of interest. A lawyer may represent two clients so long as he reasonably believes he can do so and that there is no conflict of interest between them. If there is a conflict of interest he must (1) reasonably believe he can adequately represent each of them, (2) disclose the conflict, under the Cal RPC such disclosure must be in writing, and (3) must get the clients' consent in writing. While potential conflicts of interest can be waived, actual conflicts normally may not be waived by the parties because a reasonable attorney would not believe they could represent clients with an actual conflict.

In this case, there is no conflict of interest, potential or otherwise, between Corp and its shareholders. Therefore, Al did not violate any rules by drafting the agreement.

ADVISING BOB -

CONFLICT BETWEEN BOB AND CATE-

CURRENT CLIENTS- As noted previously a lawyer may not represent one client who has a conflict of interest with another client unless (1) the lawyer reasonably believes he can adequately represent each of them, (2) the lawyer discloses the conflict, under the Cal RPC such disclosure must be in writing, and (3) the client consents in writing. While potential conflicts of interest can be waived, actual conflicts normally may not be waived by the parties because a reasonable attorney would not believe they could represent clients with an actual conflict.

In this case, it is unclear who Al represented in the drafting of the shareholder agreement and whether or not he continues to represent Cate. If Al does represent Cate

then agreeing to represent Bob in this matter constitutes a current conflict between clients, and Al would have to provide written disclosure and receive written consent. However, even if he did he would not be able to maintain representation because a reasonable lawyer would not believe he could adequately represent both Cate and Bob because their conflict is not just potential, it is an actual conflict.

FORMER CLIENTS- A lawyer may not represent a current client (1) in a matter that is the same or substantially the same as a matter he represented a former client, and (2) the current client's interests are adverse to the former client unless he gets written consent from the former client.

In this case, if Al represented Cate in drafting the shareholder agreement and proxy agreement then he would likely be in violation of this rule. Cate is a former client, and the matter now in dispute is whether the very agreements Al drafted for Cate are valid, and thus it is the same matter. Furthermore, Bob's position, that the agreements are not binding, is directly in conflict with Cate's interest. As a result Al could not represent Bob without Cate's approval because doing so would be in violation of his duty of loyalty to a former client.

Al could also be disqualified if he had gained confidential information in representing Cate, though that is unlikely here, considering he was drafting a shareholder agreement.

ESSAY QUESTIONS AND SELECTED ANSWERS
FEBRUARY 2012
CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the February 2012 California Bar Examination and two answers to each question that were written by actual applicants who passed the examination after one read.

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Question 4

Testco, Inc. conducts market surveys, and is solely owned by Amy, Ben, and Carl. Each paid $50 for one-third of Testco's no-par shares. Amy and Ben, respectively, are Testco's president and secretary and its only two directors. Carl holds no office and is not involved in any aspect of Testco's business. Amy and Ben are scrupulous about holding directors' meetings to conduct corporate business and to make monthly distributions to the shareholders of almost all cash on hand. As a result of the latter practice, Testco has little cash on hand and frequently finds itself in the position of negotiating extensions for payment of its debt.

While Ben was on vacation, Examco called Amy, asking to enter into a one-year contract with Testco. Amy said that if Examco would agree to a ten-year contract, Testco would grant its standard fifty-percent discount. Examco agreed, and Amy signed the contract in the following manner: "Testco, by Amy, President." When Ben returned, he said that he had thought for some time that Testco's standard fifty-percent discount was unwise, and convinced Amy to revoke the contract with Examco.

Examco wants to sue Testco, Amy, Ben, and Carl for damages. If found liable, Testco will not be able to pay.

On what theory or theories may Examco bring an action for recovery of damages against:

1. Testco? Discuss.

2. Amy, Ben, and Carl as individuals? Discuss.

QUESTION 4
Answer A

Examco v. Testco

Breach of Contract

If Testco is to be found liable to Examco, it will be on a breach of contract theory. Breach of contract occurs where there is a valid contract, a breach, and then damages as a result of the breach. A valid contract exists when there is an offer, acceptance, consideration, and no defenses to contract formation.

Here, Examco asked Amy to enter into a ten-year contract, which Amy then signed on behalf of Testco. Amy agreed that in consideration for the length of time of the contract, that she would give Examco a fifty percent discount. Thus there was a valid contract between both Examco and Amy on behalf of Testco.

A breach of the contract occurred when Amy anticipatorily repudiated the contract between the two companies. It is likely that Examco will receive damages as a result of not getting the benefit of their bargain with Testco; thus there is a valid action for breach of contract. However, Testco will only be bound to this contract if Amy had authority to enter into the agreement with Examco (see below).

Agency

Agency is where a principal with capacity manifests assent that an agent act on behalf of the principal for its benefit and subject to its control followed by the agent manifesting assent to do the same. Here, Amy as president of Testco was an agent of the company since she was appointed to the position of president (assent), working for the benefit of the company, and subject to the control of the board of directors. Thus

Amy was an agent of Testco and Testco will be liable on the contract with Examco if she had some form of authority to enter into the contract.

Amy's Authority

A principal is liable on the contracts entered into by their agent on their behalf so long as the agent has authority. Authority can come in three forms: actual authority, apparent authority, and ratification.

Actual Authority

Actual authority is the authority that the agent reasonably believes that they have based upon the manifestations of the principal. Actual authority can be express or implied.

Express Actual Authority

Express actual authority is the authority given from the four corners of the agency agreement.

Here, there is no agency agreement between Amy and Testco; however, there is probably some sort of express manifestation of assent in the bylaws or articles of incorporation of Testco. Usually in the corporate setting, when a contract such as this is entered into, the board of directors will usually vote to pass a resolution to give the president of the company the authority to enter into the contract. However, there was no such board resolution here since Amy did not consult with Ben prior to signing the contract. Since there are no facts going to express authority, a different form of authority must be found to bind Testco to the contract with Examco.

Implied Actual Authority

Implied actual authority is the authority that the agent reasonably believes that they have based upon necessity in order to carry out their express authority, customs of the position held by the agent, and by prior dealings with the principal.

Here, Amy, as president of Testco, would likely have implied actual authority to enter into the Examco contract by virtue of her position as president of the company. Presidents of corporation[s] customarily have the authority to enter into binding contracts with other companies. Additionally, it is necessary for a president to enter into contracts with other companies in order to make the corporation profitable. Making the corporation profitable is a duty of the president of the company and thus it is necessary that Amy entered into this contract in order to fulfill that duty.

Testco will argue that, although Amy was president and had authority to enter into smaller contracts, this contract was different in the fact that it went ten years into the future and that Amy was giving such a huge discount. Testco will argue that this sort of contract required express board resolution and thus Amy could not have reasonably believed to have authority to enter into it. However, the facts state that Amy gave the "standard fifty-percent discount;" thus it seems like this was a regular occurrence of the corporation to enter into contracts of this nature. As such there was implied actual authority.

Apparent Authority

In the event that the court finds that there was no actual authority, they could find apparent authority to bind Testco to the contract. Apparent authority is the authority that a third party reasonably believes that the agent possesses based upon the manifestations of the principal. One form of manifestation by the principal would be the position that the principal has placed the agent in is a position that is usually associate[d] with the grant of authority.

Here, Examco can successfully argue that Amy had apparent authority do [sic] to her title of president of Testco. When they were entering into the contract they dealt

directly with the president of the company. Additionally when the contract was signed, it was signed "Testco, by Amy, President". As such, it would have been reasonable for Examco to believe that Amy had apparent authority to enter into the contract.

Ratification

Another form of authority is ratification. Ratification occurs where after the agent has entered into a contract, the principal has knowledge of it and accepts its benefits. Here, when Amy told Ben about the contract, he told her to immediately revoke it. Thus there was no board resolution ratifying the contract with Examco and there will be no finding of authority based upon ratification.

Conclusion

Since there is at least the finding of apparent authority on behalf of Amy for Testco, Testco is bound to the contract with Examco and will be liable to them on a theory of breach of contract.

Examco v. Amy, Ben, and Carl as Individuals

Liability of Shareholders

Shareholders of a corporation are only personally liable for the cost of their shares of stock in the corporation. They are not personally liable for the corporation's debts, liabilities, or obligations. Thus, Amy, Ben, and Carl will not be liable to Examco personally unless the corporate veil can be pierced (see below).

Piercing the Corporate Veil

In order to recover from the personal assets of the shareholders of Testco, Examco will have to make a sufficient showing to pierce the corporate veil. The corporate veil is pierced based upon a variety of factors. These factors include whether

there was fraudulent conduct by the shareholders, whether the corporation is undercapitalized, whether the corporation is simply an alter ego of the shareholders, and whether the creditor of the corporation is an involuntary creditor.

Fraud

Fraud is the misrepresentation of a material fact known to be false with the intent to induce some action upon another where the other suffers damages. Here, the facts do not suggest that Amy made any misrepresentations when entering into the contract with Testco; thus a pierce of the corporate veil will not be achieved on the ground of fraud.

Alter-Ego

A corporation acting as the alter ego of the shareholders will be found where the shareholders forgo the usual formalities of corporate status. Here, Testco has officers and a board of directors; however, the facts state that Amy and Ben are "scrupulous" about holding director's meetings to conduct business. Thus it could be seen that they have foregone the formalities of a usual corporation. Thus this factor weighs in favor of a pierce of the veil.

Undercapitalization

Undercapitalization of a corporation occurs where the corporation does not keep enough surplus cash on hand in order to pay the foreseeable liabilities of the corporation. Here this factor weighs heavily on favor of piercing the veil since all of the extra cash on hand was distributed to the shareholders. It was foreseeable that eventually a contract would be breached or some mistake would be made causing liability on behalf of Testco. Thus since there was not enough cash on hand to pay the liability to Examco, the veil may be pierced.

Involuntary Creditor

An involuntary creditor is usually a tort victim or tort judgment holder. Here, Examco had every opportunity to inspect records and the financial security of Testco prior to entering into the contract. Thus they were not an involuntary creditor.

Carl's Liability

Usually a shareholder that is uninvolved with the daily operations of the company will not be held liable as a result of veil piercing. Here, Carl did not participate in any of the activities of Testco except to receive distributions from the company. Thus he may or may not be held liable to Examco.

Conclusion

The factors presented above weigh in favor of piercing the corporate veil; thus Examco may go after the shareholders of Testco, with the possible exception of Carl.

QUESTION 4
Answer B

The remedies that are available to Examco for Testco revocating their agreement depend on the legal status of the agreement and whether Amy had the authority under agency principles to bind Testco to the agreement if it can be legally enforced. The agreement concerns money which is proper consideration from Examco to Testco for providing its market survey services. There were negotiations between both parties regarding the price and discount that would be offered as well as the length of the contract. Both parties agreed on the 10 year terms and the 50% discount. Amy signed the contract. This is enough to create a legally enforceable contract if Amy had the authority to enter into contracts on behalf of the corporation — this is determined by principles of agency which I now analyze.

Amy as Agent of Testco

An agent is a person or entity that acts on behalf of another, the principal. For an agency relationship to exist there must be assent by the agent to the existence of the relationship and its duties, the agent must act for the benefit of the principal, and the principal must control the agent's actions on its behalf.

Here Amy is the President of the corporation. She has assented to the relationship by accepting this employment and the duties and privileges (e.g., salary, benefits) that come along with it. She acts for the benefit of the corporation in this capacity. This is because by virtue of her position in the management of the corporation as an officer she has a Duty of Care to the corporation and must act in good faith and as a reasonably prudent person would with his or her own business. Further, in addition to this Duty of Care she also has a Duty of Loyalty whereby she must act in the best interest of the corporation before all others including herself. These duties insure that Amy's actions should be for the benefit of the corporation in all actions she does on its behalf. Third, the corporation itself has control over Amy. This is because Amy is an employee of the corporation and serves at the will of the board of directors and at its direction. Her

employment can be terminated at any time by the board or shareholders (by majority vote at a meeting or special meeting).

Because the three prongs of agency have been satisfied, Amy is an agent of the corporation. As such, she may be able to bind the corporation to agreements depending on whether she has the appropriate authority to do so.

Actual Express Authority

Actual express authority is the authority that is expressly given to an agent by a principal for some particular task. This authority can be orally conveyed or it can be in writing. According to the equal dignity rule, if a writing would be required for the transaction or action at issue if the principal were to act directly for himself instead of through his agent, the principal is required to expressly give the agent express written authorization to undertake the action on the principal's behalf.

There is no factual information to suggest that Amy had either oral or written actual express authority to enter into contracts on behalf of the corporation. Further, even if the board or shareholders expressly passed a resolution stating that Amy had such authority, or that the President of the corporation has such authority, the resolution and authorization it granted must be in writing. This is due to the equal dignity rule. Because the contract that was actually signed by Amy called for her firm's services to be rendered over the course of 10 years, the Statute of Frauds requires a signed writing (because performance necessarily will take longer than one year by the terms of the contract). Amy herself signed such a writing. However, there is no evidence to suggest that the board gave her such written authorization.

Thus, Amy did not have actual express authority to enter into the contract on behalf of Testco on the basis of the factual information given. However, she may have had implied authority to do so.

Actual Implied Authority

Actual implied authority is that authority which is necessary for it to carry out its expressly authorized actions and in fact was implied from that authorization, or authority that comes with virtue of the position the agent has with respect to the principal and the duties associated with this position.

Here if Amy had received express authority from the board to manage all sales regarding Testco's service contracts, she would have the implied authority to enter into a contract with Examco at terms that she determined because such authority is necessary to manage all sales of service contracts. However, since there is no evidence of an express authorization this prong of implied authority will not suffice.

The second possibility that will give rise to implied authority is if the agent by virtue of his or [her] position and the duties associated with such a position has authority to enter into a contract. Here Amy has been appointed by the board of directors of Testco as its president. As such, she is the chief executive officer of the corporation and is responsible for overseeing all day-to-day operations of the corporation. By virtue of this position and the duty that comes with it — to manage the corporation — Amy has the implied authority to act on the corporation's behalf in her management of the corporation.

Thus, when she signed the contract with Examco she was acting with the implied authority granted to her by virtue of her position as president charged with management of the company. On this basis, Testco can be held liable for a breach of contract.

Apparent Authority

Apparent authority is the authority that arises when a third party reasonably believes that the agent has such authority because the principal "cloaked" the agent with the appearance of such authority.

Here Amy is the president of the corporation. She holds herself out as such when she entered into the contract with Examco. By virtue of permitting Amy to negotiate such service agreements, which appears to be the case given Ben's objection to the usual 50% reduction, Testco was holding her out to third parties as having the authority to enter into such agreements. Further, Amy signed the contract with Examco as "Testco, by Amy, President." Acting in the cloak of authority given to her by Examco by virtue of her ability to negotiate sales service agreements with customers and by virtue of the apparent authority she has as Testco's president, she had the apparent authority to bind the corporation when contracting with a third party, here Examco, who reasonably believed she had such authority.

Thus, because Amy had the implied authority and apparent authority to enter into this contract on Testco's behalf and she did so, Testco is liable for breach of the contract by its revocation. Examco can seek damages directly against Testco.

2) The determination of whether there is liability for Amy, Ben, and Carl will depend on whether there is director liability for Amy and Ben in their capacities as directors and officers of the corporation. And for all three, Amy, Ben, and Carl based on whether the veil can be pierced for purposes of their limited liability.

Piercing the Veil

Directors, managers, and shareholders are generally not liable for their actions to a third party that is suing the corporation. That is true, unless the corporate veil that insulates them from liability can be pierced. Piercing of the corporate veil is an extraordinary remedy that is only awarded when the directors, officers, and shareholders do not provide for sufficient capital or insurance for the corporation's debts and where the corporation is but an alter ego of the shareholders. The latter can be established in part by the officers and managers not observing sufficient corporate formalities.

Undercapitalization

Directors are not permitted to make a dividend distribution that puts the corporation at risk for insolvency. In fact, the prohibition against this is so strong that the directors will be personally liable for such a distribution unless they believed the corporation was not at risk of insolvency based on the financial officer's report which they are allowed to reasonably rely upon.

Amy and Ben

Here Amy and Ben voted in favor of making monthly distributions that put little cash on hand and leading to the corporation needing to negotiate extensions for payment of its debt. This put the corporation at risk for insolvency because if a large judgment came through or one of its creditors was unwilling to renegotiate its payment terms. Amy and Ben as shareholders and directors did this to benefit themselves at the expense of the corporation. This violated their duty of loyalty to act in the best interests of the corporation above even their own. They did not do this because they held 2/3 of the shares and put the corporation at risk of insolvency merely to line their own pockets with distributions. This would also violate their duty of care to the corporation because they would not put themselves at such risk of insolvency in the management of their personal business. This undercapitalization will lead to Examco likely not being able to recover its damages for breach of its contract. It should be permitted to recover its expectation damage measure, the amount it reasonably expected to profit from the agreement at the time it was entered into.

Courts are more likely to pierce the veil for a tort action than they are for a contract dispute.

Here we have a contract dispute between a corporation and another corporation. It is due to the fact that Amy and Ben determined that the contract would not be profitable. While normally this would not be such an egregious breach, because it may lead to an overall benefit if the breach was efficient, here it is especially so because Amy and Ben

have undercapitalized the corporation and there are likely no assets which Examco can reach when it successfully sues. As such, the court should pierce the corporate veil to allow Examco to recover the impermissible cash distributions that Amy and Ben had been awarding themselves and would otherwise be available.

Carl

While Carl is also a shareholder and normally his 1/3 interest in the corporation would be sufficient to raise him to the status of a controlling shareholder, here he does not have such control. Amy and Ben are the only two officers, the only two directors, and when combined they hold a 2/3 interest in the corporation as shareholders. Carl is merely a passive investor that is not involved in any aspect of Testco's business. He merely invested $50 in no-par stock in a venture run by Amy and Ben. As such, while the veil should be pierced for Amy and Ben as to their shareholders' limited liability but should not be for Carl because he committed no improper acts and was merely a passive investor.

Limited Liability

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ESSAY QUESTIONS AND SELECTED ANSWERS

FEBRUARY 2013

CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the February 2013 California Bar Examination and two selected answers to each question.

The answers received good grades and were written by applicants who passed the examination. The answers were prepared by their authors, and were transcribed as submitted, except that minor corrections in spelling and punctuation were made for ease in reading. The answers are reproduced here with the consent of their authors.

Question 6

In 2011, Molly and Lenny started a computer software business. Molly prepared marketing materials and Lenny made sales calls. During the first year, Lenny sold 10 copies of certain software programs for $50,000 each. The business had a net profit of $480,000 and Molly and Lenny each received $240,000.

In January 2012, Molly and Lenny hired an attorney to incorporate their business under the name “Software Inc.” The attorney properly prepared all necessary documents to incorporate the business but carelessly failed to file them with the Secretary of State.

Lenny continued to make sales calls to sell the software. He also sold a five-year service contract developed by Molly. Due to brisk sales, Software Inc. projected income of about $300,000 per year for the next five years from the service contracts alone. Software Inc. obtained a $100,000 business loan from National Bank secured by the accounts receivable for the service contracts.

In May 2012, Lenny had an automobile accident, caused solely by his own negligence, on the way to visit a prospective buyer. The accident injured a pedestrian. As a result of the accident, Lenny stopped working and sales collapsed.

In July 2012, Software Inc. went out of business, leaving negligible assets and the unpaid loan to National Bank.

1. Is Software Inc., Molly, and/or Lenny liable to the pedestrian for the injury? Discuss.

2. Is Software Inc., Molly, and/or Lenny liable to National Bank for the loan? Discuss.

ANSWER A TO QUESTION 6

I. Liability to the Pedestrian

A. Lenny's Liability

This issue is whether Lenny is liable to the pedestrian for the automobile accident.

Generally, persons are liable for their own negligent conduct. While employers can be vicariously liable (discussed below) for an employee's tortuous conduct, this liability is in addition to the employee's liability. However, if an employee was acting within the scope of their employment, to further the goals of the business, they could seek indemnification from the business.

Here, Lenny had an automobile accident, caused solely by his own negligence, on his way to visit a prospective buyer. The accident injured a pedestrian. Lenny will most likely be liable for the damages he caused. However, because he was on his way to visit a prospective buyer, Lenny could seek indemnification from Software Inc., because he was driving solely for the purpose of furthering Software's business by attracting a new buyer. In addition, his conduct was negligent, rather than intentional, which would prohibit indemnification. If, because of a failure to incorporate (as discussed below), Software Inc. is not actually a valid corporation, Lenny could still seek indemnification from the partnership between him and Molly, since he was still acting in furtherance of Software, the partnership (also discussed below). However, given Software's negligible assets, and its debt to National Bank, there may not be much to seek indemnification from.

Therefore, Lenny is liable to the pedestrian, but may be able to seek indemnification from Software, Inc.

B. Software Inc.'s, Vicarious Liability

This issue is whether Software Inc. is vicariously liable for Lenny's tortuous conduct.
A corporation/partnership/principal can be vicariously liable for the tortuous conduct of its agents if those agents act in furtherance of the principal, under the principal's control, and with the principal's express, implied, or apparent authority.

Here, Lenny had an automobile accident, caused solely by his own negligence, on the way to visit a prospective buyer. By driving to visit a buyer, it appears clear that Lenny was acting in furtherance of Software Inc. While Software Inc.'s corporation or partnership status will be discussed below, it is clear that Lenny was functioning as both a principal and as an agent. He was a principal in the sense that he was expressly authorized to make sales calls and presumable visit prospective buyers given that he started the computer software business and that he and Molly agreed to divide the work as such. He was an agent acting for the benefit of Software Inc. in driving to meet the buyer and further Software Inc.'s goals of collecting buyers.

Therefore, regardless of Software Inc.'s status, Software Inc. is probably vicariously liable for Lenny's tortuous conduct.

C. Molly's Liability

1. De Facto Corporation

This issue is whether Software Inc. had a de facto corporation status, such as to shield Molly from personal liability for Lenny's tortuous conduct.

A corporation is a unique organizational framework for a business, in which management is centralized, and shareholders enjoy limited liability. A corporation must file its articles of incorporation with the Secretary of Interior in order to be a valid corporation, and thus to enjoy this limited liability. However, a corporation that does not

file its articles of incorporation may nevertheless enjoy limited liability via de facto corporation. A de facto corporation 1) attempted to incorporate in good faith, 2) is otherwise eligible to incorporate, and 3) subsequently acted like a corporation in good faith.

In January 2012, Molly and Lenny hired an attorney to incorporate their business under the name "Software Inc." However, while the attorney properly prepared all necessary documents to incorporate the business, he carelessly failed to file them with the Secretary of State. It does not appear that Molly or Lenny knew that the attorney had failed to file the documents. Instead, Molly and Lenny continued to make sales and sell the software. In fact, they obtained a business loan from National Bank secured by its accounts receivable, thereby acting like a corporation in which corporation debts are secured by corporation profits. By hiring an attorney, and subsequently acting like a corporation, it appears that Molly and Lenny attempted to incorporate in good faith, and later acted as if they were a corporation in good faith, with no knowledge (or should have had the knowledge) that they were not actually a corporation. In addition, Software Inc. appears otherwise eligible to incorporate, but-for the failure to file the documents with the Secretary of State.

Therefore, it is possible that Molly will be shielded from liability if Software Inc. has de facto corporation status.

2. Piercing the Corporate Veil

This issue is whether Molly can be personally liable if the pedestrian pierces Software Inc.'s corporate veil.

Shareholders of a valid corporation may nevertheless be personally liable for corporation debts if the corporate veil is pierced. Courts allow a corporation's veil to be pierced when it is clear that there is such a commonality between the corporation and the shareholders, that the shareholders are actually the "alter ego" of the corporation,

and to not permit piercing would sanction a grave injustice. Failing to comply with corporate formalities and insufficient capitalization are common reasons courts have pierced a corporation's veil.

Here, if Software Inc. has de facto corporation status, Molly can be shielded from liability, unless Software Inc.'s corporate veil is pierced. There is no evidence that Molly and Lenny intentionally aimed for Software Inc. to act as their corporate alter ego. However, there is evidence that Software Inc. was severely under-capitalized. In 2011, Molly and Lenny made a net profit of $480,000. However, instead of investing any of that profit back into the business, they instead each received $240,000. In 2012, Software Inc. sold a five-year contract, and projected an income of $300,000/year based just on service contracts. In addition it took out a $100,000 loan. However, in July 2012, after Lenny stopped working for just two months, Software Inc. had only negligible assets AND its unpaid loan. It appears that either Molly and Lenny were taking dividends when the corporation could not pay its debts, or that Software Inc. was otherwise severely under-capitalized. Further, there are no facts to suggest that Molly and Lenny abided by any corporate formalities, such as holding a general meeting, issuing bylaws, or keeping accounting books. However, there is no information that they did not do these things either.

Therefore, it is possible that the pedestrian can pierce Software Inc.'s corporate veil and hold Molly personally liable.

3. General Partnership

This issue is whether if Software Inc. does not have a corporation status, they are instead a general partnership, and Molly can be held personally liable thereby.

A general partnership is a partnership between two or more people to go into business together. The formation of a general partnership only requires the intent to form a partnership. No documents need to be filed with the Secretary of State, unlike a limited partnership, a limited liability corporation, and a corporation. A general partnership only includes general partners who are personally liable for the debts and obligations of the partnership. The equal sharing of profits is presumptive evidence that parties intended to form a general partnership.

In 2011, Molly and Lenny started a computer software business. Molly prepared marketing materials and Lenny made sales calls. At the end of the year, the business had a net profit of $480,000, and Molly and Lenny each received $240,000. In 2012, Lenny and Molly continued to operate their software business in apparently the same way, with the same division of labor, as they had in 2011. They attempted to form a corporation, but their attorney negligently failed to properly file the forms. By sharing the profits equally in 2011, Molly and Lenny appeared to have presumptively formed a general partnership. In 2011, it appears that they operated as a general partnership, with an equal, but distinct division of labor. By sharing the profits, they implicitly agreed to also equally share the business's obligations, should there be any. When the attorney failed to incorporate Software, and assuming that Software is unsuccessful in obtaining de facto corporation status, Molly and Lenny continued to have a general partnership. It does not matter that they never formally agreed to form a partnership. Their sharing of the profits equally makes their relationship a general partnership until they agree otherwise. Thus, if Software Inc. does not have de facto status, Molly will be liable as a general partner. However, she will only be liable to the extent the business is without funds.

Therefore, Molly can be liable as a general partner.

II. Liability to National Bank

A. Software Inc.'s Liability for the Loan

This issue is whether Software Inc. is liable for the loan to National Bank.

Generally, corporations and partnerships are liable for the debts incurred during the normal course of business.

Here, National Bank issued a $100,000 business loan to Software Inc., secured by Software Inc.'s accounts receivable. If Software Inc. has de facto status, then the loan was authorized by the corporation. If Software Inc. is a partnership, the loan was similarly taken during the course of business, for the purpose of the partnership, and was authorized by the partners. Regardless of Software Inc.'s status, the loan was received by Software, which subsequently enjoyed the benefits of the loan, and will thereby be held to have at least ratified the loan by accepting the loan.

Therefore, Software Inc. is liable for the loan, regardless of its status.

B. Lenny and Molly's Liability for the Loan

1. De Facto Corporation

This issue is whether Lenny and Molly can escape personal liability through de facto corporation.

This rule is discussed above, in section I.C.1.

Because Lenny and Molly made a good faith attempt to incorporate, and acted in good faith as if they were incorporated, they potentially could receive de facto corporation status, and thereby its included limited liability.

Therefore, Lenny and Molly could escape liability through de facto status.

2. Corporation by Estoppel

This issue is whether Lenny and Molly can escape personal liability through corporation by estoppel.

Even if a corporation fails to properly file its articles of incorporation with the Secretary of State, and even if a corporation fails to receive de facto corporation, a creditor may nevertheless be estopped from denying the existence of a corporation. If a creditor treated a corporation as such, and looked to corporate assets in making a loan, a corporation can be protected though corporation by estoppel.

Here, Software Inc. projected income of about $300,000/year for the next five years from its service contracts. National Bank provided Software Inc. a $100,000 business loan secured by the accounts receivable for the service contracts. National Bank believed Software, Inc. was a valid corporation. They could have done their due diligence to verify their corporation status. Further, National Bank only looked to Software Inc.'s assets, not Molly or Lenny's, in determining whether to issue the loan. Finally, they issued a business loan, underpinning National Bank's focus upon Software as a corporation. Because they treated Software as corporation in issuing the loan, they will be estopped from denying Software's corporation status in attempting to collect on the loan.

Therefore, Molly and Lenny could escape personal liability through corporation by estoppel.

3. Piercing the Corporation Veil

This issue is whether even if Software Inc. has de facto or corporation by estoppel, National Bank can go after Molly and Lenny personally by piercing the corporate veil.

This issue is discussed above, in section I.C.2.

Because Lenny and Molly failed to properly capitalize Software Inc., it is possible that National Bank could similarly seek to pierce Software's corporate veil.

Therefore, Molly and Lenny could be personally liable for the loan thru piercing the corporate veil.

4. Liable as General Partners

This issue is whether if there is corporate status, Lenny and Molly are liable as general partners.

This issue is discussed above in section I.C.3. General partners are personally liable for the remaining debts of the business.

Because Lenny and Molly originally functioned as a general partnership, if Software Inc. does not have corporate status, Lenny and Molly will be held to be general partners. Just as general partners get to share profits equally, they also must share the obligations equally.

Therefore, Molly and Lenny will each be liable for one half of the remaining obligation on the loan to National Bank.

ANSWER B TO QUESTION 6

Liability towards Injured Pedestrian:

Software Inc. v. Pedestrian

De Jure Corporation:

A de jure corporation is one that is properly formed. To form a de jure corporation the parties have to prepare the necessary documents required by the state for incorporation. Here, Molly and Lenny did not create a de jure corporation due to the fact that their attorney carelessly failed to file the documents. The fact that the corporation was not created does not mean that there are not other corporate like entities that could have arisen.

De Facto Corporation:

Molly and Lenny's strongest argument would be that they created a de facto corporation. A de facto corporation is where the parties take all the necessary steps to incorporate, but for some reason their attempt to incorporate was unsuccessful. If the parties have a good faith belief that a corporation was formed a court can find that a de facto corporation was created, which gives the parties all the same benefits and obligations that would arise under a normally created corporation. Based upon these facts a court would most likely find that a de facto corporation was created, Lenny and Molly took all the necessary steps to create a corporation and held themselves out to be a corporation and if it were not for the carelessness of their attorney in filing the paperwork they would be considered a corporation.

Liability of Shareholders in a De Facto Corporation:

Now that it is found that a de facto corporation was created we look to see if it is liable towards the pedestrian for the injuries suffered. The bonus of a corporation is that it protects its shareholders from liability, and therefore if a de facto corporation was formed Software Inc. might be liable for the injury, and possibly Lenny as it was caused by his negligence but Molly would be shielded from liability beyond what she had invested in the company.

Liability of a Corporation for Damages Caused by its Agents

A corporation can be liable for damages caused by its agents during the scope of their employment. In a corporation directors and officers are considered agents of the corporation and this is further demonstrated by the fact that they had the ability to bind Software Inc. to contracts and that they seemed to be the only two people working for the corporation. If the damages were created completely outside of the scope of their employment then a corporation will not be found to be liable for the damages but here based upon the facts Lenny was going to visit a prospective buyer and his driving to the meeting was within the scope of his employment.

What the corporation would have to argue is that while the accident occurred on his way to the meeting it did not benefit from Lenny's reckless driving and therefore the corporation would not be liable because the accident was caused by Lenny's negligence. This argument would most likely fail because a corporation can be held liable for negligent acts by their employees if they are not wandering too far from the scope of their employment and since Lenny was on the way to the meeting he was not wandering outside of the scope of employment and therefore the corporation can be held liable for the injuries caused to the pedestrian.

Lenny v. Pedestrian

The question would be whether Lenny could also be held liable due to his negligent acts. The Pedestrian would argue that Lenny negligently caused the injuries that he suffered and while as a SH of the corporation he might not be held liable he could still be held liable for negligently driving and causing the accident. The fact that Lenny was working in furtherance of the business interests of the corporation does not mean that he could not be held liable separately. Due to the fact that the accident was caused solely by his negligence Lenny could be found liable for the injuries to the plaintiff along with the corporation.

Molly v. Pedestrian

If a de facto corporation is formed then Molly cannot be held personally liable for the actions of the agents of the corporation. The only time a shareholder can be liable is if the plaintiff is able to pierce the corporate veil by showing that the corporation was merely an alter ego of the party or that it was underfunded. This is not the case here and therefore Molly would not be liable if a de facto corporation was formed.

General Partnership:

If the courts find that no de facto corporation was formed then Molly and Lenny would be in a general partnership with one another. A general partnership arises when two people agree to enter into a business venture for profit. That is demonstrated by the fact that previous to their attempted incorporation Molly and Lenny worked together selling software equipment and that they equally split their profits between each other. Under a general partnership the partners are not protected from liability like a shareholder of a corporation is. Therefore, if a general partnership is formed and a party brings a suit against one partner for damages arising out of their work for the partnership then all partners are personally liable for any award against the partnership. Therefore, unless Molly was able to argue successfully that Lenny's actions were

outside of the scope of the partnership then she would be held personally liable for any damages that are caused by the actions of Lenny. Because it does not seem likely Molly would be able to successfully argue that his actions were outside of the scope of employment, both Molly and Lenny would be personally liable for any injury suffered by the other party due to Lenny's accident.

Liability towards National Bank for Loan:

Corporation by Estoppel:

Even if a de facto or de jure corporation is not formed Molly and Lenny could argue that a corporation by estoppel was formed. Their argument would be that even if they were not a corporation the fact that National Bank dealt with them as if they were a corporation would estop them from denying that they were a corporation and holding the shareholders personally liable.

Software Inc. would be Liable

Software Inc. would be liable for the loan obtained from National Bank. The loan was taken out by them as a corporation and there does not seem to be any evidence to demonstrate that it was taken out for anything other than proper purposes. National Bank would try to argue most likely that Software Inc. is not liable for the loan because at this time Software Inc. only has negligible assets and therefore this would not provide much capital to repay the loan to National Bank.

Most likely Software Inc. would not be attempting to escape liability as they are already out of business and only have negligible assets so a recovery against them would not harm the corporation. This could lead National to make an argument to pierce the corporate veil because of undercapitalization but this argument would fail because the business was not undercapitalized; instead it was not able to fulfill the contract which was the basis on which National Bank loaned the money to them.

Because Software Inc. took out the loan and there is no evidence that it was used for any purposes other than to help the company they will be found liable to the bank for the loan and therefore National Bank will be able to bring an action against Software Inc., even though there is little for them to recover.

Molly would not be Liable

Unless a general partnership was formed as discussed above Molly will not be liable for the National Bank loan. The fact that National Bank acted as if it was dealing with a corporation would stop it from then asserting that it was in actuality a partnership and so therefore Molly would not be liable under a theory that it was merely a partnership.

As a shareholder in a corporation she is protected and there is no evidence to show that she did anything that would cause her to not be protected. National Bank might try to argue that it based its loan based upon the accounts receivable from the service contract developed by Molly but this argument would fail. She created the service contract within the scope of her employment and there is no evidence to show that she was at fault in any way for the failure of the business. Due to the fact that National Bank would not be able to show that Molly did anything that would make her liable for the losses suffered by Software Inc., a court would not find her liable to National Bank and she would therefore be safe.

Lenny would not be Liable

Due to the fact that Software inc. left negligible assets when it went out of business for National Bank to collect on they would most likely go after Lenny for the damages. Their argument would be the fact that the reason for the failure of the corporation was the fact that Lenny stopped working due to the car accident. They would argue that he was the person that created the revenue for the corporation through his sales calls and once he stopped working Molly did not have the experience

to continue running the business profitably and therefore by Lenny's actions the corporation went out of business. They would argue that his quitting was not in the scope of his employment and that it was in no way beneficial to the business and they would therefore argue that Lenny should be liable because their loss is due to Lenny's decision to not return to work.

Lenny would argue that even if his failure to go to work was the cause of the business to fail that does not make him liable for the debts entered into by the business. There is nothing here showing that Lenny or Molly did anything improper in obtaining the loan and that the loan was made with the corporation based upon the assets of the corporation and therefore Lenny should not be held liable.

Even though it seems like National Bank has an argument based upon the fact that the sole reason that the business failed was the fact that Lenny stopped going to work, this would not be sufficient to create liability on Lenny's behalf because the bank loan was entered into by Software Inc. and not with Lenny. Additionally, Lenny could argue that the loan was based solely upon the service contracts and not the sale of products, which was his main area of involvement. Alternatively, National Bank will argue that while it might have been prepared by Molly, Lenny was the one that sold the service contract and therefore it was his area of involvement. Even if the court found this they still would not find that Lenny had acted sufficiently in bad faith to find that he was liable to National for the loan.

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ESSAY QUESTIONS AND SELECTED ANSWERS

JULY 2014

CALIFORNIA BAR EXAMINATION

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Question Number	Subject
1.	Contracts/Remedies
2.	Evidence
3.	Business Associations / Professional Responsibility
4.	Criminal Law and Procedure
5.	Trusts / Community Property
6.	Torts

Question 3

Alice's and Bob's law firm, AB Law, is a limited liability partnership. The firm represents Sid, a computer manufacturer. Sid sued Renco, his chip supplier, for illegal price-fixing.

Renco's lawyer asked Alice for a brief extension of time to respond to Sid's interrogatories because he was going on a long-planned vacation. Sid told Alice not to grant the extension because Renco had gouged him on chip prices. She denied the request for an extension. Sid also told Alice that he'd had enough of Renco setting the case's pace, so he wasn't going to appear at his deposition scheduled by Renco for the next week, and that he'd pay his physician to write a note excusing him from appearing. Alice did nothing in response.

In the course of representing Sid, Alice learned that Sid planned a tender offer for the publicly-traded shares of chipmaker, Chipco. Alice bought 10,000 Chipco shares. By buying the 10,000 Chipco shares, she drove up the price that Sid had to pay by $1 million. When Alice sold the 10,000 Chipco shares, she realized a $200,000 profit.

1. What ethical violations, if any, has Alice committed regarding:

    a. The discovery extension? Discuss.

    b. The physician's note? Discuss.

    c. The Chipco tender offer? Discuss.

    Answer according to California and ABA authorities.

2. What claims, if any, does Sid have against Alice, AB Law, and Bob? Discuss.

QUESTION 3: SELECTED ANSWER A

Governing Law: California is governed by the California Rules of Professional Responsibility as well as certain sections of the business code. The ABA has promulgated its Model Code of Professional Responsibility as well.

(1) What ethical violations, if any, has Alice committed regarding (1) the discovery extension, (2) the physicians' note, or (3) the Chipco tender offer?

Discovery Extension:

Duty of Fairness: An attorney has a duty of fairness to the opposing party to act in good faith. While an attorney has no duty to accept all requests made by opposing counsel if not required, and while an attorney has a competing duty to her client to act in the client's best interests and should advocate for her client's interests zealously, denial of a good faith request for a short extension may be considered a breach of A's duty of fairness to opposing counsel.

Here, Alice ("A") represents Sid ("S") in suing Renco ("R"). R's attorney has requested a brief extension to respond to interrogatories. The reason for R's request is to go on a long-planned vacation. Without a showing that R's counsel has continuously attempted to delay the litigation by asking for continuances and extensions, A's duty of fairness likely requires her to accept such brief extension. Her denial is based on her client's order that it not be granted for no other reason than "because R had gouged him on chip prices". Because if R's counsel requested an extension from the court based on good reason it might well be granted, it is improper for A to require such unnecessary resort to the court. A has likely violated her ethical duties of fairness.

Duty of Loyalty: An attorney has a duty of loyalty to always act in her clients' best interests and not to engage in conflicts of interest or compete with the client.

Here, A will likely argue that her duty of loyalty to S requires that A not fail to acquiesce to her client's requests. However, the duty of loyalty does not extend this far. An attorney must not advocate for her client to the point that it causes her to make other ethical violations.

Scope of Decision-Making: While the client has the right to state which claims he or she wishes to pursue and make major decisions regarding settlement or whether to plea, etc., it is within the attorney's scope of authority to determine the proper strategy for effectuating these goals.

A should not allow S to "order" her to deny the extension based on no substantive reason. This is within A's scope of authority to decide, and A should not acquiesce to a bad-faith denial of a good-faith request. If A and her client cannot agree on the scope of representation, withdrawal from the case may be appropriate to avoid A being pulled into improper conduct.

Physician's Note:

Duty of Candor/Honesty: An attorney must not make any false representations to the court or opposing counsel, and must not allow her client to make any false representations to the court.

Here, A has stated that he is going to bribe his doctor to get a note to excuse him from appearing at his deposition. This will constitute a fraud upon the court because it is not true that D is unavailable. Further, there is no valid reason for S to fail to appear at his deposition. An attorney can breach his or her ethical duties by failing to speak when she has a duty to counsel her client against illegal or fraudulent activity and advise him that he or she cannot be a part of such conduct. Here, when A failed to respond to S's statement, she impliedly acquiesced in his proposal. This is an ethical violation because it will cause A to participate in a fraud upon the court and will violate her duty of candor.

Withdrawal: An attorney must withdraw from a case when she learns of conduct that will constitute a crime or fraud that will necessarily involve the lawyer's services. If it will not involve the lawyer's services, the attorney may but does not need to withdraw.

Here, paying one's doctor to write a false note excusing him from appearing may constitute such improper behavior that reflects poorly upon the profession. Such conduct is clearly in bad faith and relates directly to the representation, directly involving A. Thus, A should have withdrawn from the representation had she not been able to dissuade S from failing to appear at his deposition for a fraudulent reason because she will necessarily be involved.

Duty of Confidentiality: An attorney has a duty of confidentiality not to disclose any information related to the representation of the client. However, there is an exception to this rule which allows disclosure if the attorney learns that the client plans to commit a crime or fraud. Further, California imposes a duty on an attorney who has learned that his client plans to commit a crime or fraud to attempt to dissuade the client from his proposed actions and further, if that fails, to tell the attorney that the attorney plans to disclose the information to the appropriate authorities.

Here, it is unclear the length S plans to go to in order to get him a "note". However, this likely does not constitute an actual crime or fraud, so A likely has no right to breach her duty of confidentiality to her client. Since she has not, she has not violated this rule.

Duty to Diligently Pursue Completion of the Case: An attorney has a duty to diligently pursue a case to completion without allowing it to languish in the court system.

Here, by impliedly acquiescing in S's statement that he plans to fail to appear at his deposition, this will require a further scheduling out of a deposition at a time convenient

for the parties and court reporter. This is a bad faith delay of the case that constitutes breach of A's ethical duties.

Chipco Tender Offer:

Duty of Loyalty: As stated above, an attorney has a duty of loyalty to her client to always act in the best interests of the client. This includes not acquiring an interest adverse to the interest of the client. California allows an attorney to obtain an interest adverse to that of her client in certain circumstances.

Here, when A learned of S's plan to make a tender offer for the publicly traded shares of Chipco, she immediately purchased Chipco shares and then sold them for a $200,000 profit. A's acquisition of these funds constitutes a breach of A's duty not to obtain an interest adverse to her client's, because the price S had to pay on the shares was raised by one million dollars. A has caused serious financial injury to S by acquiring an adverse interest and essentially taken a profit that should have gone to S. In doing so, A has breached her ethical duties.

Conflict of Interest: An attorney has a concurrent conflict of interest when there is a substantial likelihood that her ability to represent her client will be materially limited by her own personal interests, her duties to another client, a former client, or a third party. An attorney may take on the representation despite the concurrent conflict of interest if the attorney can believes that she can competently and adequately represent the interests of the parties, and if she obtains written consent from all involved parties. California has no "reasonable lawyer" standard and does not require written consent, only written notice, when the interest is personal to the lawyer.

Here, in gaining a personal interest in Chipco, A may have created a conflict that will materially limit her representation of S. However, A may argue that this is a deal on the side and is unrelated to the subject of the litigation in which she represents S; and further, A may argue that ownership of the shares has no bearing on her representation of S. If the court determines that she has acquired a conflict of interest, A has breached

her duty by failing to get written consent. In California, she has further breached her duty by failing to give written notice to S.

Duty of Confidentiality: See above. In using confidential information S provided to her in telling her about the tender offer for her own benefit, A may have breached her duty.

(2) What claims, if any, does S have against A, AB Law, and B?

Limited Liability Partnership: A limited liability partnership is a special type of partnership that affords limited liability to all its partners, created by filing a Statement of Qualification with the Secretary of State. In a limited liability partnership, the individual partners are not personally liable for any damages sustained by the partnership itself.

A: See above.

A will be personally liable for her own torts.

B: See above.

Because B is a partner in an LLP, he has limited liability. Thus, S will have no claim against Bob ("B") A's partner.

AB Law:

Authority: A partnership is liable for its partner's actions if the partners have authority to act for the partnership. Authority may be actual (express or implied), apparent, or ratified. Actual authority exists where a reasonable person in the agent's position would believe he had the right to act on behalf of the business. This may be express, through an agreement, or implied, through actions or conduct. Apparent authority exists where a reasonable person in the shoes of the third party believed that the person had authority to act. Ratification occurs where no authority exists but the business has

adopted the contract through action such as accepting its benefits. A partner in a partnership has both apparent and implied authority to act on behalf of the partnership.

Here, as a partner of AB law, A has actual authority to act on behalf of the partnership. Her acts taken in the scope of her law practice will thus subject the partnership to liability. Thus, A will both be personally liable for her own torts, and S will further be able to collect against AB Law for her actions.

Unjust Enrichment:

Here, S will sue A personally and AB Law for likely malpractice for losses caused by her breaches of her duties. Her misconduct has led to a loss by S of 1 million dollars, and has resulted in a gain to A of $200,000. In equity, a court may under unjust enrichment theory disgorge profits made by someone and impose a constructive trust. A constructive trust is not truly a trust but is an equitable remedy imposed by the court which forces the wrongdoer to hold unjustly realized profits in trust for the benefit of the rightful owner. Because she has been unjustly enriched by action taken in breach if her duties to S, the court will likely impose a constructive trust on the profit realized by A and will thus force A as trustee of these funds to distribute them to their proper owner, S.

Intentional Interference with a Business Expectancy: Intentional interference with business expectancy occurs where a person knows of a business expectancy of another party and knowingly interferes with that expectancy, resulting in damages. Here, S had planned a tender offer with C. Her actions in purchasing Chipco shares may constitute an interference with this expectancy with S, although A will argue that this expectancy is not yet an enforceable contract and that she has a valid defense of fair competition. This will be balanced by the court.

QUESTION 3: SELECTED ANSWER B

Discovery Extension

Scope of Representation

A client usually determines the ends (goals) of a representation, whereas the lawyer generally determines the means (legal strategies). If a client is insisting upon actions that the lawyer does not wish to take, the lawyer may limit the scope of employment through informed written consent by the client. Here, it appears that Alice let Sid influence her legal decision-making by telling her to deny the request for an extension to respond to Sid's interrogatories. This type of decision should normally be decided by the lawyer because it falls into legal strategy. Although it is permissible for the lawyer to seek the client's input, the final decision should ultimately be left up to the lawyer. Alice let Sid control the litigation means.

Fairness to Opposing Counsel/Adverse Parties

A lawyer should treat opposing counsel and adverse parties fairly during the representation. A lawyer should not engage in certain actions if it is known to be for the purpose of harassing or making a task unduly burdensome for opposing counsel/adverse party. Here, Sid told Alice to reject the request to extend the time for answering the interrogatories. Renco's lawyer asked for a reasonable "brief extension" to respond since he was going on a long-planned vacation. This seems to be a reasonable request and is not an attempt by Renco's attorney to delay for an improper purpose. Sid's reasons for wanting to deny the extension, however, would be considered improper. He denied the request because Renco had "gouged hi on chip prices," so he was acting out of spite. He told this directly to Alice, so she knew his improper motives. She should have counseled him to allow the extension since it was a reasonable request and made clear that Sid's motives were improper. Because she did not do this, Alice violated her duty of fairness to Renco and its lawyer by furthering her client's improper purpose.

That being said, a lawyer does owe a duty to her client to diligently dispose of the case (work productively and not delay unnecessarily). If for some reason the extension requested was unreasonable, or it had been one of many requests for extensions, then perhaps Alice would be justified in denying the request. She has a duty to her client to make sure that his case is handled efficiently and effectively. The facts do not suggest this was the case, but if it was, then again it is possible she may not be in violation of an ethical duty.

Physician's Note

Duty of Candor

A lawyer owes a duty of candor to opposing counsel, adverse parties, and the court. A lawyer must not submit evidence that she knows to be false or make a false statement of fact or law that she knows to be untrue. If she makes such a statement without knowing it is false and later learns of its true nature, the lawyer has a duty to correct the evidence or testimony.

Sid told Alice he was not going to appear at his deposition for Renco the next week because he'd had enough of Renco setting the case's pace. He also told Alice that he was going to pay his physician to write a note excusing him from appearing at the deposition. Alice did nothing in response. Alice knows that Sid is not sick and that he just does not want to attend the deposition. He is going to get a fake doctor's note written to excuse him, so this would be false "evidence" or a false statement of fact being presented to the opposing side. Alice has a duty not to allow such false information to be presented to the other side. That being said, there is a conflict with her duty of confidentiality to Sid not to disclose his statements to her since they were made during and related to the representation.

A lawyer owes a duty of confidentiality to her client for anything related to the representation, even if not made by the client. Under the ABA, a lawyer may reveal confidences if the client persists in engaging in criminal or fraudulent conduct that will

result in death or serious bodily harm, or if the lawyer's services are being used to perpetuate a crime or fraud by client that will result in serious financial harm. California does not have an exception for financial losses. Neither of these exceptions appears to be present. Sid's actions will not cause harm to anyone to the extent of death or serious bodily harm. It may pose a financial burden on Renco because they have to pay the lawyer for time that was spent preparing and now it will be postponed, but the amount spent is not likely to satisfy the requirement of financial harm under the ABA. Therefore, since no exception applies, Alice cannot reveal Sid's confidences.

So Alice cannot reveal the confidences but she must not present false evidence. What she should have done is counseled Sid by trying to get him to show up for the deposition and not pay a doctor to make a false note. If that did not work, then she should have withdrawn from the representation since he was persisting in engaging in fraudulent conduct. If the withdrawal would be harmful to Sid, a court might not let her withdraw and it may request why she is choosing to withdraw. If that is the case, then Alice may reveal Sid's confidences regarding the letter. Because Alice did not take these steps and said nothing when Sid mentioned a fake doctor's note, she breached her duty of candor to Renco and its lawyer.

Duty of Fairness

Again, as mentioned earlier, Sid has improper motives for wanting to submit the doctor's note and not attend the deposition. He wants to regain control of the pace of the litigation and is acting out of spite toward Renco for the price he was charged for the chips. Alice should know based on the comments Sid has made to her that he only wants to delay the case for improper purposes. Because she is aware of this, Alice is violating her duty of fairness to opposing counsel and adverse party.

Chipco Tender Offer

Duty of Loyalty

A lawyer owes a duty of loyalty to her client. If the interests of another client, the lawyer, or a third party materially limit the lawyer's ability to effectively represent the client, then she has a conflict of interest. The lawyer must act in the best interest of the client. Tied with the duty of confidentiality mentioned below, a lawyer also cannot use information learned during the course of the representation to the disadvantage of her client.

Alice used the information she learned from Sid during the representation that Sid was going to make a tender offer to her advantage by purchasing shares of the stock and driving up the price. Alice benefitted by realizing a $200,000 profit while Sid had to pay $1 million more than he would have before she purchased the shares. Alice was looking out for her interests first and negatively impacted her client's interests in the process. Because she subordinated her client's interests to her own, Alice violated the duty of loyalty she owed to Sid.

Duty of Confidentiality

A lawyer owes a duty of confidentiality to her client. She must not reveal any information related to the representation that she learns, and she must not use that information to the disadvantage of her client.

Here, Alice learned while representing Sid that Sid planned to tender offer for the publicly-traded shares of Chipco. She used this information to Sid's disadvantage by purchasing 10,000 Chipco shares, which drove up the price that Sid had to pay. Although this purchase is unrelated to the representation, it involved information learned during the representation. The duty of confidentiality is broad and covers any information related to the representation. Alice may try to argue that this information is unrelated to Sid's illegal price-fixing claim against Renco, but it would likely be found to be covered by the duty of confidentiality. Price-fixing involves the market of that particular industry, and if Sid intends to make a tender offer for a competitor chipmaking company, it would affect the same market involved in the litigation that she is representing Sid for against Renco. Therefore, a court would find that the information is attenuated but still within the realm of the confidences covered by the duty of

confidentiality. Since Alice used the information against Sid to his disadvantage, she violated her duty of confidentiality.

Sid v. Alice, AB Law, and Bob

AB Law is a limited liability partnership (LLP). A limited liability partnership operates almost exactly the same as a general partnership except the partners in an LLP are not personally liable for the debts of the partnership like they are in a general partnership. Therefore, the partnership is liable for the negligent acts (but not intentional torts) of its partners but the other partners are not personally liable for different partner's negligent acts or debts of the partnership. A partner always remains liable for her own actions.

Alice

Alice obviously violated several of her ethical duties. The breach of the duty of loyalty that she committed against Sid by purchasing Chipco stock caused actual pecuniary harm to her client. This was an intentional act on Alice's part. Under her breach of the duty of loyalty, since she financially benefitted from her actions, realizing a $200,000 profit from buying and selling her shares of stock, she would be liable to Sid for profits realized as a result of her breach of the duty of loyalty. Therefore, Alice is personally liable for $200,000. She may also be liable for the harm caused to Sid by the breach. Sid had to pay $1 million more than he otherwise would have if Alice had not purchased the shares. But for Alice's purchase of the stock, Sid would not have had to pay $1 million more for the tender offer. It was also foreseeable to Alice that if she purchased the shares, it would drive the price of the stock up for Sid's tender offer. Therefore, she is also liable as the actual and proximate cause of Sid's loss due to her breach. Alice is personally liable for $1,200,000 to Sid.

As for a specific claim, Sid may be able to claim misappropriate. Alice was in a relationship of trust and confidence with him as a fiduciary. Sid had nonpublic information that most people would find material, meaning it was affect whether someone would purchase a stock or not. Sid did not tell this information to Alice for an

improper purpose and surely did not anticipate she would use the information to purchase stock. Therefore, Sid would not be a tipper and Alice cannot be a tippee. But she can be a misappropriator since she was in this fiduciary relationship with the source of the non-public material information and she purchased stock in reliance on that information. Therefore, she is liable to Sid for the same amount of damages mentioned above because they were profits that would need to be disgorged and harm caused from her misappropriation.

Bob

Because these actions were taken by Alice, even if the partnership is liable, Bob cannot be personally liable for the harm caused by Alice. It is a limited liability partnership, so partners are not personally liable for the debts of the partnership or torts of other partners. Therefore, Sid does not have any claims against Bob.

AB Law

A partner is an agent of the partnership and thus can bind the partnership to certain obligations. The partnership is also liable for the negligence or non-intentional torts committed by partners while in the scope of employment for the partnership.

Here, Alice was working as Sid's lawyer when she learned the information that she misappropriated from him. Her actions, however, would likely be considered beyond the scope of her employment as a partner. She took the information and used it for personal reasons. If she had, for example, not filed an important document on time resulting in a dismissal with prejudice, then Sid could sue for malpractice and the LLP would be liable because the claim arose from her duties as a lawyer. This harm caused to Sid was not because of Alice's actions as an attorney for Sid. Therefore, a court would likely find that the LLP is not liable for Alice's actions and Sid has no claim against AB Law. If the court did find her actions were within the scope of her duties as a partner, then AB Law would also be liable for the losses Sid incurred.

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ESSAY QUESTIONS AND SELECTED ANSWERS

FEBRUARY 2015

CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the February 2015 California Bar Examination and two selected answers for each question.

The answers were assigned high grades and were written by applicants who passed the examination after one read. The answers were produced as submitted by the applicant, except that minor corrections in spelling and punctuation were made for ease in reading. They are reproduced here with the consent of the authors.

Question Number	Subject
1.	Contracts
2.	Real Property
3.	Civil Procedure
4.	Remedies
5.	Business Associations
6.	Wills/Trusts

QUESTION 5

Andy, Ruth, and Molly decided to launch a business called The Batting Average (TBA), which would publish a monthly newsletter with stories about major league baseball players. Andy, a freelance journalist, was responsible for writing the stories. Andy conducted all of his business activities via a close corporation called Baseball Stories, Inc., of which he was the only employee. Ruth was responsible for maintaining TBA's computerized subscriber lists, mailing the newsletter every month, and billing TBA subscribers. Molly provided all equipment necessary for TBA. Andy, Ruth, and Molly expressly agreed to the following: Molly would have exclusive authority to buy all equipment necessary for TBA; and TBA's net profits, if any, would be equally divided among Andy, Ruth, and Molly.

Andy subsequently wrote a story in the newsletter stating that Sam, a major league baseball player, had been taking illegal performance-enhancing drugs. Andy knew that the story was not true, but wrote it because he disliked Sam. As a result of the story, Sam's major league contract was terminated. While writing the story, Andy's computer failed. He bought a new one for TBA for $300 from The Computer Store. The Computer Store sent a bill to Molly, but she refused to pay it.

Sam has sued Andy, Ruth, Molly, TBA, and Baseball Stories, Inc. for libel.

The Computer Store has sued Andy, Ruth, Molly, and TBA for breach of contract.

1. How is Sam's suit likely to fare? Discuss.

2. How is The Computer Store's suit likely to fare? Discuss.

QUESTION 5: SELECTED ANSWER A

1. Sam's Suit

1-1. Does Sam have a valid claim for libel against Andy?

The issue is whether Sam has a valid claim for libel for the story Andy wrote. In order to claim a libel, a plaintiff must show that (i) there was a defamatory statement, (ii) of or concerning the plaintiff, (iii) which was published, and (iv) resulted in a harm to the plaintiff's reputation. When the plaintiff is a public official or a public figure, the plaintiff must also show (i) the defendant acted with malice, and (ii) the defendant's statement was false.

Defamatory Statement of or concerning the Plaintiff. For a claim for a libel, the defamatory statement cannot be a mere name calling but in general must allege a specific fact that is harmful to the reputation of the plaintiff. Also, it must identify the plaintiff. Here Andy wrote a story in the newsletter stating that Sam, a major league baseball player, had been taking illegal performance-enhancing drugs. The article specifically identified Sam and it specifically alleged that Sam took illegal performance-enhancing drugs. Therefore, there were allegations of specific acts of wrongdoing that were allegedly committed by Sam. Therefore, Andy's article constitutes a defamatory statement of or concerning the plaintiff.

Publication. Publication requires that the defendant share a defamatory statement at least with one person other than the plaintiff. Here Andy published his article in the newsletter with subscribers. Therefore, there was clearly a publication.

Damages. In a libel case, damages to the reputation can be presumed if the plaintiff meets all the requirements for defamation and also show malice and falsity. A libel is a publication of a defamatory statement in a written form. Here, as will be discussed below, Sam should be able to meet all the requirements so the damages can be

assumed. Also, the article constitutes a libel as it is a publication in a written form with subscribers. Even if the damages were not presumed, Sam's major league contract was terminated as a result of Andy's story. Thus, Sam would be able to show he suffered harm to his reputation as shown by his losing the contract. Therefore, Sam can show damages.

Malice. Given the constitutional protection of free speech, a public official or a public figure must meet a higher burden of proof in order to win in a defamation suit. A public official is a government official and a public figure is a figure well known in the society, such as celebrities or professional sportsmen. A public official or a public figure must show, in addition to the 4 requirements of defamation that the defendant acted with malice. In this context, in order to show malice, a plaintiff must show that (i) a defendant had actual knowledge that his statement was false, or (ii) a defendant acted with reckless disregard to the truth of his statement. Here Sam is not a public official but he is a public figure. He is a major league baseball player, not just a local player who plays for a hobby. Thus, Sam must be well known in the society and is a public figure. Thus, he must show that Andy acted with malice when he published his story. Andy published his story knowing that it is false because he disliked Sam. While the fact that he acted out of personal grudge or dislike of Sam does not show that Andy acted with malice, the fact that Andy published a defamatory article about Sam knowing that it was false shows that he acted with malice for purposes of defamation. Thus, if Sam can prove that Andy knew that the story was not true, Sam would be able to show Andy acted with malice.

Falsity. A public official or a public figure must also show that the defendant's story is not true. Here the facts indicate that Andy's story was not true so Sam should be able to meet this burden.

In conclusion, Sam is likely to succeed on his claim on defamation against Andy.

1-2. Is Baseball Stories, Inc. liable to Sam?

The next issue is whether Baseball Stories, Inc. ("BSI") can be held liable for Andy's libel. Andy, a freelance journalist, conducts all of his business activities via a close corporation BSI, of which he was the only employee. Under the theory of respondeat superior, an employer is liable for the employee's tort if the employee committed the tort within the scope of his employment. While an employer is not generally liable for an employee's intentional tort, the employer could still be liable if (i) the employee was motivated by a desire to further the employer's interest, (ii) the tort was authorized or ratified by the employer, or (iii) the tort was part of the nature of the employee's job.

Here Andy and BSI's businesses consist of writing articles for journals. Thus, Andy's publication of the article in the newsletter was within the scope of his employment. Here Andy is likely to be liable for intentional tort because he was not merely negligent in publishing the story but he intentionally published the story knowing that it was false. Sam can argue that Andy was motivated by his desire to increase subscription and popularity of the newsletter and BSI's business of publishing articles. Thus, Sam can argue that BSI should be held liable for the defamation committed by Andy.

1-3. Can Andy be held liable to Sam, notwithstanding Baseball Stories, Inc.?

A person is always liable for his or her own tort. Thus, Andy should be directly liable for the libel against Sam. Also, a court may pierce the veil and hold a shareholder liable for the tort committed by the corporation if, for example, (i) the shareholder did not treat the corporation as a separate entity and did not observe corporate formalities, or (ii) the corporation was inadequately capitalized. This is most likely in a closely held corporation and even more so when a plaintiff is a tort victim who did not rely on the limited liability of the corporation. Here BSI is a close corporation and Andy is the only employee. Thus, it indicates that Andy had a controlling influence over BSI. While a corporation can have a sole shareholder and only one employee, the corporate formalities must be observed in order to maintain the limited liability status of the

shareholder. Thus, if Andy commingled his personal funds with BSI's, used BSI's funds as if they were his own, used BSI's other assets as his own, or he inadequately capitalized BSI, Sam may be able to show that Andy and BSI are alter egos and Sam may be able to pierce the veil to reach Andy's personal assets for tort liabilities. Having said that, Andy should be directly liable to Sam in any case because it was tort committed by him personally.

1-4. Did Andy, Ruth and Molly form a partnership when they launched TBA?

Given that Andy and BSI can be held liable for Andy's libel, the next issue is whether Ruth, Molly and TBA can be held liable for Andy's libel. A partnership is formed when two or more people agree to carry on a business as co-owners for profit. No specific formalities are required to form a general partnership and whether the parties intended to form a partnership does not matter as long as there was an agreement to carry on a business enterprise for profit. Here Andy, Ruth and Molly decided to launch a business called The Batting Average (TBA). It is not clear from the name what type of entity they intended to form. However, it was formed to publish a monthly newsletter with stories about major league baseball players. Also, there is no indication it was intended to be a non-profit organization. In fact, Ruth was responsible for maintaining the subscriber lists and billing the subscribers. Also, they expressly agreed that TBA's net profits, if any, would be equally divided among Andy, Ruth and Molly. Thus, they agreed to form a business venture of publishing articles about major league baseball players for profit. Also, an agreement to share net profits shows that they formed a partnership. It does not matter that they never used the word "partnership" or they never intended to form a partnership.

The next question is what type of partnership Andy, Ruth and Molly formed as a result to determine their and TBA's liability. A default partnership is a general partnership where all partners are liable for their liabilities of the partnership. A creditor of the partnership must first look to the assets of the partnership and if they are insufficient, they can pursue the partners' personal assets. Therefore, in a general partnership, the

partners act as guarantors for the partnership liabilities. There are other forms of partnership or business enterprise that provide some form of limited liability for some or all owners, such as a limited partnership, limited liability company, a limited liability partnership or a corporation. However, they all require filing a form of certification with the Secretary of State and they each require that their names indicate a limited liability by including the words such as "limited partnership," "LP", "limited liability company", "LLC" or "Inc." or "Incorporated." There is no indication here that Andy, Ruth and Molly or TBA filed any certificate of limited partnership to form a limited partnership or a certificate of qualification to form a limited liability company, nor did they file articles of incorporation to form a corporation. Also, the name, "The Batting Average" does not have any of the words indicating that they formed a business entity with limited liability. Since no formalities were observed, they would also not be able to argue that they formed a de jure corporation. Therefore, Andy Ruth and Molly formed a generally partnership when they decided to launch their business TBA.

1-5. Can TBA be held liable to Sam for Andy's tort?

Given that TBA is a general partnership, the next issue is whether it or Ruth and Molly can be held liable for Andy's tort. A partnership is liable for tort committed by a partner in the scope of his partnership. Here Andy committed a tort while he was publishing the article for the newsletter published by TBA. Thus, TBA would be liable for the tort and Sam would be able to look to the assets of TBA. In a general partnership, all the partners are liable for the partnership liabilities if the partnership assets are insufficient to meet those liabilities. Thus, if TBA's assets are not sufficient to meet Sam's claim, Ruth and Molly could also be held liable and may be required to pay out of their own personal assets. However, Ruth and Molly may be entitled to indemnification from Andy since Andy was the tortfeasor.

In conclusion, Sam is likely to be successful on his libel claim against Andy. In such event, (i) TBA and BSI would likely be vicariously liable and (ii) if the assets of TBA are insufficient, Ruth and Molly would also likely be liable out of their personal assets.

2. The Computer Store's Suit

The issue is whether (i) Andy, Ruth and Molly formed a partnership, (ii) Andy had an express, implied or apparent authority when he bought a computer for TBA, (iii) TBA can be held liable for Andy's contract liabilities, and (iv) Ruth and Molly can be held liable.

2-1. Did Andy, Ruth and Molly form a partnership?

As discussed above, Andy, Ruth and Molly agreed to carry on a business venture of publishing monthly newsletters for profit and to share any net profits derived therefrom. They did not make any necessary filings with the secretary of state and TBA does not have a name indicating limited liability. Therefore, TBA is a general partnership.

2-2. Did Andy have an Express, Implied or Apparent Authority when he bought a computer for TBA?

The next issue is whether Andy had an express, implied or apparent authority when he bought a new computer for TBA for $300 from The Computer Store. All the partners of a partnership are considered agents of the partnership and they are generally authorized to act on behalf of the partnership relating to the partnership's business, although each partner's authority may be limited by agreement. Under the agency theory, a principal can be held liable under the contract entered into by the agent if the agent had an authority to enter into such contract. An authority can be actual or apparent. An actual authority arises when the principal either expressly grants the authority to the agent either by words or conduct or it is implied from (i) the past course of dealing between the principal and the agent, (ii) the principal's past acquiescence, or (iii) such authority is incidental to other express authority granted to the agent.

Here Andy is a partner of TBA and thus he generally had the ability to act on behalf of TBA. However, Andy, Ruth and Molly expressly agreed that Molly would have exclusive

authority to buy all equipment necessary for TBA. Therefore, Molly had the exclusive and express authority to buy all the equipment, including a computer used in the business. Since her authority was exclusive, Andy did not have an express authority to buy computers on behalf of TBA. There is no indication that TBA or Molly acquiesced in the past in Andy buying a computer. The Computer Store may argue that Andy was responsible for writing articles for TBA and thus using and buying a computer was incidental to his authority to write articles for TBA. However, given that buying equipment was Molly's exclusive authority, it is unlikely that Andy had any authority to buy equipment or computers on behalf of TBA.

The next question is whether Andy had an apparent authority to buy computers. An apparent authority arises when the principal holds the agent out to a third party as having certain authorities or powers. Given that TBA is an enterprise with only three owners and Andy was one of them and given that Andy was writing articles on behalf of TBA, The Computer Store is likely to argue that Andy had an apparent authority to buy a computer. On the other hand, TBA can argue that the fact that The Computer Store sent a bill to Molly indicates that they were aware that Molly was responsible for purchasing equipment. Also, the fact that Andy wrote articles for TBA can also only mean that he is an employee of TBA or a freelance writer. Thus, TBA may have a viable argument that Andy had neither actual nor apparent authority when he bought the computer and thus it should not be liable under the contract. However, even when the agent did not act with actual or apparent authority, the principal can be held liable if the principal later ratified the contract, which can be either express or implied if the principal kept the benefits of the bargain. Here, if TBA kept the computer and used it, there is likely to be ratification and thus TBA would be liable for $300 to The Computer Store.

2-3. Can Andy, Ruth and Molly be held liable for breach of contract?

Assuming that Andy acted within the scope of authority on behalf of TBA when he bought the computer or TBA later ratified the contract by keeping the benefits, the next issue is whether TBA's partners, Andy, Ruth and Molly can be held personally liable. As

discussed above, they formed a general partnership. In a general partnership, partners are liable for the partnership liabilities. Thus, if TBA's assets are not sufficient to meet the liabilities to The Computer Store, they can each be held liable and required to pay out of their personal assets.

QUESTION 5: SELECTED ANSWER B

General partnership

A general partnership is an association between two or more people to carry on as co-owners a business for profit. There are no formalities required to form a partnership. There is no writing requirement or filing requirement with the Secretary of State. The subjective intent of the parties is immaterial. All that is required is that they intend to carry on as co-owners a business for profit. In other words, a partnership is formed, simply by meeting the definition of a partnership. Here, Andy, Ruth and Molly decided to launch The Batting Average (TBA), a business to publish monthly newsletters with stories about major league baseball players, and agreed to assign responsibilities among themselves for the management of the business. Furthermore, the sharing of gross profits gives rise to a presumption of partnership formation. Here, Andy, Ruth, and Molly expressly agreed to share TBA's net profits equally among themselves.

Andy, Ruth, and Molly formed a general partnership.

Sam v. Andy

General partners are always liable for their own torts. Thus, if Andy is found liable for libel, he will be personally liable for the tort regardless of the liability of TBA.

Libel

A prima face case for libel requires a defamatory statement, of or concerning the plaintiff, publication, and damages. In addition, when the defamatory statement concerns a public figure, such as a major league baseball player, the plaintiff must prove falsity and fault. For the fault requirement, a public figure must prove actual malice. Actual malice exists when the defendant knew that statement was false or recklessly disregarded the truth or falsity of the statement. Here, Andy wrote a newsletter stating that Sam, a major league baseball player, had taken illegal performance-enhancing drugs.

Defamatory statement of or concerning the plaintiff

A statement is defamatory if it adversely reflects on the plaintiff's reputation. Here, the statement that Sam was taking illegal performance-enhancing drugs clearly lowers his reputation in the community and in his profession. In fact, his major league contract was terminated due to Andy's newsletter. Furthermore, while the facts do not present the newsletter, it is safe to assume that Andy at least mentioned Sam by name. As a result of the newsletter, Sam was terminated.

Publication

For publication, the defamatory statement must be made to a third person who understands it. This requirement is clearly satisfied as Andy published the story in a newspaper.

Damages

Sam suffered general and special damages. For libel, damage to reputation may be presumed and as his contract was terminated, Sam has also suffered pecuniary loss.

Falsity and Fault

The facts state that Andy "knew that the story was not true". This would satisfy both additional requirements for constitutional damages as the statement is in fact false and Andy acted with actual malice when he published the newsletter knowing it was not true. The fact that he wrote the story because he disliked Sam would not establish actual malice, but his intentional disregard for the truthfulness of his statement satisfies.

Thus, Sam will be successful in a suit against Andy for libel.

Liability of Baseball Stories

In terms on Baseball Stories' and TBA's liability for Andy's tort, the issue is whether Andy was acting as an agent and whether he was acting within the scope of his employment and/partnership. An employer/partnership will be vicariously liable for torts committed by agents/employees/partners that are within the scope of scope of

employment/partnership. Sam would argue that because Andy conducts all of his business via Baseball Stories and is its only employee he was acting within the scope of his employment and Baseball Stories is vicariously liable.

Liability of TBA

A partnership is vicariously liable for torts committed by agents of the partnership that are within the scope of the partnership. General partners are agents of the partnership. Thus, Andy is an agent of TBA and TBA will be liable for Andy's tort if he was acting within the scope of TBA.

Sam could also argue that Andy was working on a computer purchased for TBA, and Andy was responsible for writing stories for TBA; thus he was acting as an agent of TBA and within the scope of his partnership.

Liability of Molly and Ruth

General partnerships are jointly and severally liable for all partnership obligations. Thus, a tort judgment creditor may sue any general partner for his entire loss. However, the creditor must first exhaust partnership resources before seeking payment for partners individually. Thus, Sam could hold Molly and Ruth personally liable for Andy's tort, but Sam must first exhaust TBA's resources. If he fails to do so, Molly and Ruth could look to the partnership for indemnification and/or contribution from the partners.

2. Computer Store's suit

A partnership will be liable for contracts entered into on its behalf by agents who have actual or apparent authority or contracts that have been ratified by the partnership. Partners are agents of the partnership. Thus, Andy, Ruth, and Molly are agents of TBA.

To determine whether the principal (TBA) will be bound if must first be determined whether the agent (Andy) had actual or apparent authority or the TBA ratified Andy's purchase.

Actual express authority

There is actual express authority when such authority is granted in the four corners of the partnership agreement or expressly granted by a requisite vote. Here, Andy, Ruth, and Molly agreed that Molly would have exclusive authority to buy all equipment necessary for TBA. There were no changes made to this agreement by the partners and Andy did not receive permission from Ruth and Molly to purchase a new computer for TBA. Thus, Andy did not have actual express authority.

Actual implied authority

There is actual implied authority, when the agent reasonably believes he has authority based on the manifestations of the principal. As stated above there have been no such manifestations by TBA. Furthermore, it is unreasonable for Andy to believe he has such authority because the partnership agreement between him and Ruth and Molly expressly grants such authority to Molly.

Apparent authority

Apparent authority is based on the reasonable expectations of a third party. Where a principal holds out an agent as possessing authority and a third party reasonably relies on such holding out, there is apparent authority. While TBA has not made direct representations to The Computer Store on behalf of Andy's authority, generally partners have authority to enter into contracts in the ordinary course of partnership business. Furthermore, apparent authority may be created by an agent's title. For example, if Andy told The Computer Store he was a partner of TBA, such an expression would reasonably induce The Computer Store to rely on Andy's authority as a partner. Thus, even though Andy did not have actual authority to purchase the computer for TBA he likely had apparent authority, which would bind TBA for the contract.

Ratification

Ratification occurs where an "agent" purports to act on behalf of the principal when in fact he does not have actual or apparent authority, and the principal subsequently

ratifies the action (with full knowledge of its terms). There are no facts to suggest that TBA ratified Andy's purchase and thus ratification is not available to bind TBA.

Liability

As mentioned above, general partners are personally liable for partnership obligations. Thus, if apparent authority is found, The Computer Store will have a claim against TBA, Andy, Ruth, and Molly.

Even though Molly will be personally liable to Computer Store, she may seek indemnification from TBA and may also seek contribution from Andy and Ruth as partners. In addition, Ruth and Molly and likely to have a claim against Andy for violation of the partnership agreement.

Community Property

ESSAY QUESTIONS AND SELECTED ANSWERS

JULY 2002 CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the July 2002 California Bar Examination and two selected answers to each question.

The answers received good grades and were written by applicants who passed the examination. The answers were prepared by their authors, and were transcribed as submitted, except that minor corrections in spelling and punctuation were made for ease in reading. The answers are reproduced here with the consent of their authors and may not be reprinted.

QUESTION 6

In 1997, Hank and Wanda, both domiciled in Illinois, a non-community property state, began dating regularly. Hank, an attorney, told Wanda that Illinois permits common-law marriage. Hank knew this statement was false, but Wanda reasonably believed him. In 1998, Wanda moved in with Hank and thought she was validly married to him. They used Hank's earnings to cover living expenses. Wanda deposited all her earnings in a savings account she opened and maintained in her name alone.

In February 2000, Hank and Wanda moved to California and became domiciled here. By that time Wanda's account contained $40,000. She used the $40,000 to buy a parcel of land in Illinois and took title in her name alone.

Shortly after their arrival in California, Wanda inherited an expensive sculpture. Hank bought a marble pedestal for their apartment and told Wanda it was "so we can display our sculpture." They both frequently referred to the sculpture as "our collector's prize."

In March 2000, a woman who claimed Hank was the father of her 6 year-old child filed a paternity suit against Hank in California. In September 2000, the court determined Hank was the child's father and ordered him to pay $800 per month as child support.

In January 2002, Wanda discovered that she never has been validly married to Hank. Hank moved out of the apartment he shared with Wanda.

Hank has not paid the attorney who defended him in the paternity case. Hank paid the ordered child support for three months from his earnings but has paid nothing since.

1. What are Hank's and Wanda's respective rights in the parcel of land and the sculpture? Discuss.

2. Which of the property set forth in the facts can be reached to satisfy the obligations to pay child support and the attorney's fees? Discuss.

Answer according to California law.

ANSWER A TO ESSAY QUESTION 6

1. Hank (H) and Wanda's (W) Rights to the Parcel of Land and the Sculpture

Hank and Wanda's rights to the parcel of land and the sculpture will be determined according to their status as married couples.

Putative Spouse

A putative spouse is one who reasonably believes they are married to another but for some reason their marriage is invalid. Here W believed she was married to H because she believed a common-law marriage was permitted in Illinois. Because H lied to W only he knows they were not really married and thus W's status as a putative spouse should be established.

The courts have yet to determine whether H would be considered a putative spouse under these circumstances because he knew no common-law marriage was established, however in this case the court should find that H and W are in a Putative Marriage because of W's reasonable belief that she was married in Illinois via a common-law marriage due to H's (an attorney) representation that they were married. California recognized Putative Marriages as an alternative to common-law marriages, and because H and W are currently domiciled in California a punitive marriage is established.

Quasi-Marital Property (Q-MP)

In California all property acquired during the putative marriage is deemed marital property and treated the same as community property. Such property acquired by gift or inheritance during the marriage is the spouse's separate property (SP) as well as any property acquired before the putative marriage and after permanent separation is the SP of the acquiring spouse.

In determining the character of any property the court will consider the above general presumptions as well as the source of funds used to acquire any property, any actions taken by the parties, and any special presumptions that may apply to the property. Property acquired outside California is treated as quasi-marital property and the court will treat it as community property or marital property I[f] such property were to be community property if acquired in California.

With these general principles in mind we can now examine the properties at issue.

Illinois Parcel of Land

The source of the Illinois parcel of land was the $40,000 W had earned from her earnings during marriage to buy the land. Thus, since the earning[s] were earned during the marriage it is Q-MP earnings and so the parcel is Q-MP in which both H and W have a ½ interest in.

Wanda took title in her name alone which could be deemed as a valid transmutation, which after 1985 requires a writing expressly stating that such property is the spouse's SP. If H knew and consented to W taking title in her name alone this could be SP, however, absent such consent the land would still be Q-MP.

Married Women's special presumption gives W a presumption of SP if title is taken in her name alone, however, such a presumption would not apply here because it is only applicable to property acquired before 1975 by W. Here the general presumption would apply and since the source was Q-MP and it was acquired during marriage the land should also be Q-MP.

Sculpture

The source of the sculpture was W's inheritance and so it should be deemed her SP under the general presumptions. W's statement to H that the sculpture was "our sculpture" could suffice as a valid transmutation. However, this was not in writing and a transmutation to be valid after 1985 requires that there be a writing clearly expressing a transmutation. Since there was no writing the general presumption will control and the sculpture is entirely W's SP.

2) Which Property Set Forth in the Facts Can Be Reached to Satisfy the Obligations to Pay Child Support and the Attorney's Fees?

Child Support Claim

Generally creditors' claims against either spouse are determined to be SP or Q-MP of the liable spouse depending on when such claim arose.

If the debt is SP debt then the creditor must satisfy his claim from the spouse's SP first before seeking satisfaction from the CP (here Q-MP). If the debt is a MP debt then the creditor will seek satisfaction from any MP (or Q-MP) first before seeking satisfaction of the claim from the SP of the debtor spouse.

Singe Hank's obligation to pay child support of $800 per month was a debt of H's personally and was not acquired for any benefit to the marital community such obligation is H's separate obligation. The child support claim must be satisfied from H's SP before seeking the MP.

If H is unable to pay from his SP, woman can seek satisfaction from the land as MP. However, an exception to reaching the MP earnings of the nondebtor spouse (W) arises if she has kept her earning separate with no accessibility to H.

Here W's earnings uses to buy land were deposited in an account in her own name of which presumably H had no access to, then such earnings were used to buy the land which was titled in W's name alone. Thus under this exception the claim of child support could not be reached by woman.

However still another exception arises when the debtor spouse's debt[s] are for "necessaries" which the court could deem child support payments to be. Spouses are liable to each other for necessary debts because of their duty to support each other.

Thus under this exception the child support could be satisfied from the land even if the court determined the land was entirely W's SP. She could still be liable if the child support claim were a necessary debt obligation of H.

Otherwise, if the debt is not necessary it could not be satisfied from the land because of the action's taken by W to separate her MP earning or if it was deemed entirely W's SP.

Attorney's Fees

The court provides that attorneys' fee's can if not paid give the attorney a right to a real property lien and any of the SP of the debtor spouse of the MP of the spouses. This is known as the family lawyer's real property lien.

Further if such debt were deemed necessary the fee could be satisfied from either the sculpture or the land.

If should be noted, however, that generally creditors' claims cannot reach the SP of the nondebtor spouse unless such was a necessary debt, thus as to the child support claim the sculpture which is W's SP should not be subject to the child support claim unless it is deemed necessary. The same rule would apply to any Attorney's fees owed by H.

ANSWER B TO ESSAY QUESTION 6

CA is a community property state. All property acquired while domiciled in CA is presumed to be community property. All property acquired before marriage and when the economic community has come to an end and all property acquired by gift and inheritance is separate property.

Property acquired while a married couple is domiciled in a non-community property state, becomes quasi-community property when the couple moves to California so long as it would have been community property if acquired while domiciled in California.

Before discussing Hank and Wanda's respective rights, it is important to determine the status of their relationship.

In 1997, Hank and Wanda, both domiciled in Illinois, a non-community property state, began dating. Hank told Wanda that Illinois permits common-law marriages. Hank knew the statement was false, but Wanda reasonably believed him. In 1998, Wanda moved in with Hank, thinking they were validly married. As a result of Wanda's mistaken belief that she was validly married to Hank, Wanda is a putative spouse.

Because Wanda is a putative spouse, quasi-marital property law will apply. Quasi-marital property law will apply. Quasi-marital property law is the same as community property law. As a result, the moment Wanda and Hank moved to California, all the property acquired by either of them while living in Illinois will be quasi-community property (so long as if it would've been community property if acquired while domiciled in California).

1. Hank's and Wanda's Respective Rights In The Parcel of Land and the Sculpture

Parcel of Land

Wanda used $40,000 from a savings account to purchase the parcel of land. The source of the money in the account was all of Wanda's earnings acquired while domiciled in Illinois. Because the $40,000 would have been community property if it was acquired while the couple was domiciled in California, it is considered quasi-community property.

The $40,000 of quasi-community property was used to purchase the parcel of land. In order to determine the character of a piece of property, a party must trace to the source. The land was purchased with quasi-community property and is therefore quasi-community property.

Wanda, however, took title in her name alone. Because this took place post-1974, Wanda will not be entitled to the Married Women's Special Presumption (applies pre-1975 and presumes that property is the woman's separate property so long as title is in her name alone). Wanda will try to argue that it was a gift of quasi-community property to her as separate property. The gift argument will fail, however, because she made the "gift" to herself.

Moreover, all property acquired during marriage is presumed to be community property. Unless Wanda can rebut the presumption, the parcel of land is quasi-community property. At separation, Wanda and Hank will each take ½ of the land (or proceeds from the sale of the land).

The Sculpture

Wanda inherited the sculpture. As a result, the sculpture was Wanda's separate property in the beginning. However, Hank bought a marble pedestal and told Wanda it was "so we can display our sculpture." Moreover, both Hank and Wanda referred to the sculpture as "our collector's prize."

Hank will argue that the parties' actions transformed the character of the sculpture from separate property into community property. By referring to the sculpture as "ours," Wanda intended that the sculpture be a gift to the community.

If the court finds that Wanda intended the sculpture to be a gift to the community, then Wanda and Hank will each take ½ of the value of the proceeds.

However, any transmutation that takes place post–1984 must be in writing. There is an exception, however, for interspousal occasions, etc. Because this alleged transmutation took place in 2000, a writing is required. Because there is no writing and the sculpture was not given as a birthday or

anniversary gift (and is likely to be very valuable), then transmutation was not valid. As a result, Wanda will take the entire sculpture.

2. Which Property Can Be Reached to Satisfy the Obligations to Pay Child Support and The Attorney's Fees?

Child Support

Quasi-Community Property can be reached to satisfy the obligations to pay a creditor even when the obligation arose prior to the marriage. However, if the nondebtor spouse placed his/her earnings into a separate account in his/her name alone, creditors cannot reach the money in the account so long as the account is not accessible by the debtor spouse.

Hank's child support obligations arose 6 years ago when his child was born. Wanda and Hank were not together at the time the obligation arose. However, because the parcel of land is quasi-community property, it can be reached to satisfy the child support obligations. Wanda's sculpture, however, is her separate property. Then nondebtor spouse's separate property can't be reached to pay an obligation that arose prior to marriage.

Attorney's Fees

The attorney's fees were incurred in 2000, (during the period of time Hank and Wanda were "married"). All debts incurred during marriage may be satisfied by quasi-community property (and of course community property), the debtor spouse's separate property, and the nondebtor spouse's separate property, so long as the debt was incurred for necessaries.

Because the parcel of land is quasi-community property, it can be reached to satisfy the attorney's fees. The sculpture, however, is Wanda's separate property. The issue is whether the attorney's fees were incurred for "necessaries." Hank will argue that defending himself if in a child paternity suit should be considered a "necessary". A necessary of life, however, is [sic] food, clothing and shelter. As a result, the sculpture cannot be reached to satisfy the attorney's fees.

ESSAY QUESTIONS AND SELECTED ANSWERS

FEBRUARY 2003 CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the February 2003 California Bar Examination and two selected answers to each question.

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QUESTION 6

Henry and Wanda married in 1980 when both were students at State X University. State X is a non-community property state. Shortly after the marriage, Henry graduated and obtained employment with a State X engineering firm. Wanda gave birth to the couple's only child, and Henry and Wanda agreed that Wanda would quit her job and remain home to care for the child. They bought a house in State X using their savings for the down payment and obtained a loan secured by a twenty-year mortgage for the balance of the purchase price. Mortgage payments were subsequently paid from Henry's earnings. The title to the State X house was in Henry's name alone.

In 1990, Henry accepted a job offer from a California engineering firm. The couple moved to California with their child and rented out the State X house.

In 1992, Wanda's uncle died and left her an oil painting with an appraised value of $5,000 and a small cabin located on a lake in California. Wanda took the painting to the cabin and hung it over the fireplace.

In 1993, after reading a book entitled "How to Avoid Probate," Henry persuaded Wanda to execute and record a deed conveying the lake cabin to "Henry and Wanda, as joint tenants with right of survivorship." Wanda did so, believing that the only effect of the conveyance would be to avoid probate.

In 1995, after three years of study paid for out of Henry's earnings, Wanda obtained a degree in podiatry and opened her own podiatry practice. Her practice became quite successful because of her enthusiasm, skill, and willingness to work long hours. Henry continued to work for the engineering firm.

In 2002, Henry and Wanda separated and filed for dissolution of marriage. Wanda had the painting reappraised. The artist, now deceased, has become immensely popular, and the painting is now worth $50,000.

Upon dissolution, what are Henry's and Wanda's respective rights in:

1. The lake cabin? Discuss.

2. The painting? Discuss.

3. The State X house? Discuss.

4. Wanda's professional education and podiatry practice? Discuss.

Answer according to California law.

Answer A to Question 6

HENRY & WANDA'S RIGHTS

1. The Lake Cabin

California is a community property state. All assets acquired by earnings during the marriage are presumed to be community property. Assets acquired by gift, inheritance or devise or otherwise acquired before the marriage or after a permanent separation are separate property.

Property can change form and be transmuted from community or separate property and courts will consider the source of funds if they can be traced.

Here, the lake cabin was initially separate property because Wanda acquired the lake cabin from her inheritance. When Wanda transferred the lake cabin to Henry a transmutation occurred and the house was placed in joint names. This occurred in California.

Previously in California, a gift would be presumed to Henry based on the Lucas case. After 1987, however, any property in any joint title is presumed community property. Wanda can, however, receive the initial separate property value of the lake cabin back if she can trace the assets, such as through the title and probate documents and show it was hers. Then, if it is traced properly, any value over the separate property contribution would be divided equally. Henry would alternatively argue a gift and that each spouse receive ½ but Wanda could rebut this and rebut the community property presumption with her testimony that Henry told her it was jut to avoid probate without donative intent.

2. The Painting

Wanda inherited the oil painting so it is separate property. Wanda kept the painting at the cabin, so it could be argued that she intended to keep the painting as her separate property. No community earnings or funds were used to enhance the value of the painting and no skill or labor was used to enhance the value of the painting. Wanda should keep the painting as her separate property.

3. The State X House

The community property laws of California create a presumption that all property acquired with earnings during the marriage is community property.

Quasi community property is property acquired in another state that would be considered community property if it were acquired in a community property state. Quasi community property is treated the same as community property in the event of a divorce.

Here the house was bought in another state — non-community property with earnings, a loan and savings that were all acquired during the marriage. Although the house was in Henry's name, all contributions to the house were community contributions. Henry's earnings were community earnings, the loan was acquired by both after the marriage, so the lender's intent was to rely on the community for repayment. Also the savings were their joint savings; it appeared they were acquired during the marriage. If the house would be community property in California, since it was acquired from all community sources, then it is quasi community property and would be treated as community property in a divorce. Each spouse received one-half of community property in a divorce unless there is some exception that applies (one spouse cares for a minor child in the house, one spouse misappropriates funds, one spouse is injured and should receive personal injury proceeds). No exceptions apply here, so each spouse receives one-half of the quasi community property State X house.

4. Wanda's Education & Practice

Wanda's education is not community property. However, the community estate is entitled to repayment of her educational expenses if there is a time of 10 years or less. If less than ten years has passed there is a presumption the community has not yet received all the benefits of the enhanced earning capacity from the education.

If, however, Wanda can show the community has already received sufficient benefits, she would not have to repay the community. If she cannot prove this, then she would have to repay the education expenses (½) to Henry.

The podiatry practice was acquired exclusively from community funds (Henry's earnings) and from Wanda's enthusiasm, skill, and labor during the marriage. These are all community sources so that the practice and the goodwill of the practice should be valued and divided one-half to each spouse.

Because all sources of labor and capital are community sources, the Pereira and Van Camp methods of accounting do not apply. Pereira would allow a spouse their initial investment back if it is separate property plus a reasonable rate of return (10%) on the initial investment. Because Henry's investment in Wanda's education was community earnings, there is no initial separate property to return and Pereira does not apply, for either Henry or Wanda, since Wanda's labor was all during the marriage and was all community labor.

Similarly Van Camp accounting does not apply because this principle allows a reasonable salary to be deducted from the business, multiplied by all years of the marriage, less any community expenses paid from the business and that would be considered community property with the balance of the value of the business returned as separate property. It is inapplicable because all community labor and earnings were used for the business, resulting in a community property podiatry business.

Van Camp is used where a unique separate property business has appreciated during

the marriage due to circumstances rather than community labor. It does not apply here because there was no separate property contribution to the podiatry practice, so each spouse receives one-half of Wanda's practice.

Answer B to Question 6

1. Quasi Community Property

The threshold issue is whether the laws of California community property govern property that Harry and Wanda acquired in State X, a non-community property state. Property acquired in another state that would be considered community property if acquired in California is treated as quasi community property and is treated as community property on the dissolution of marriage.

Here, at the dissolution of Harry and Wanda's marriage, the property they acquired in State X will be treated exactly under the same principles as the property they acquired in California. Both will be governed by California community property laws.

As mentioned, California is a community property state. All property acquired during the course of marriage is presumptively community property (CP). All property acquired prior to marriage or after separation is presumptively separate property. In addition, a gift, devisee, or bequest is presumptively separate property (SP).

In order to determine the character of a property, courts will trace back the source of funding used to acquire the property. A mere change in the form of a property will not change its characterization. At divorce, each item of community property is split equally, absent special circumstances.

With these principles in mind, we can turn to the specific assets involved.

2. The Lake Cabin

The lake cabin was a gift to Wanda from her uncle and as such is SP.

Henry will argue that Wanda made a gift of the property to him in 1993 and therefore the property became CP.

Prior to 1985, gifts to a spouse did not have to be in writing. Post 1985, however, transmutations of property required writing. Henry will argue the execution and recording of the deed was a writing satisfying this requirement and, therefore, the gift should be treated as CP and he should have half of the she [sic].

Henry will also argue that, under Lucas, taking time in joint and equal form creates a presumption of community property and a relinquishment of the separate property rights. Moreover, the Anti-Lucas statutes provide that this presumption of CP holds true even for property taken as joint tenants on dissolution. While joint tenancy would not creat[e] a presumption of CP on death, it does on dissolution. Therefore, Henry will argue the fact that the property was in joint tenancy is further indication that it is community property.
Wanda, however, will counter that the only reason she put the property in her and

Henry's name was to avoid probate of the cabin. The courts have held under the Married Women's Presumption that a gift is not presumed when a party does so for improper purposes, such a shielding from creditors. By analogy, in this context the court may nor presume a gift or title in joint and equal form because it was done for an improper purpose.

In sum, if Wanda had given Henry a share in the lake cabin for a proper purpose, the Lake Cabin would be CP. But since it was done for an improper purpose, a court will probably hold it is SP and that Wanda should keep it.

3. The Painting

The painting was a gift to Wanda from her uncle, and as such was SP. Wanda is entitled to the appreciation of the painting that is now worth $50,000. This appreciation was not in any way commingled because the painting was never sold. Moreover, Wanda committed no labor in the appreciation of the painting. Therefore, Wanda is entitled to the entire appreciation of $50,000 which is simply a capital return on separate property.

4. The State X House

The State X house was bought using savings (quasi CP) and payed off using Henry's earnings (quasi CP). Therefore, it is presumptively quasi CP which is treated as CP for the purpose of dissolution. There is no need to apply Marriage of Moore because the house was entirely purchased by CP, and there is no division of CP and SP in acquiring the interest.

Henry will argue, though, that the fact that he took title alone creates the presumption of a gift to him. Prior to 1975, when a women took title alone in a property, that property was presumptively considered a gift to the women. But, this presumption did not apply to men. It also does not apply post 1975. But, Henry will still argue that this property was a gift because he was the sole title owner.

This argument is unlikely to succeed because Wanda remained in the home and cared for the child in the home. Courts will look beyond the facade of sole title, and will not interp[r]et the title as a gift to Henry. Instead, they will loo[k] at the property as jointly owned by Wanda and Henry who lived there together.

The question, then, becomes if the house is quasi CP how can it be split given that it is in a different state. California, after all, does not have juri[s]diction over property that is in State X.

Courts, however, will either give Wanda and [sic] equivalent amount of resources from other assets to compensate for the State X house, or they will force Henry, given their personal jurisdiction over him, to sign over half of the property to Wanda.

In short, Wanda is entitled to her share of half the house despite the problems of jurisdiction given that California has personal jurisdiction over Henry.

5. Wanda's Professional Education

The issue is whether Wanda's podiatry degree is community property.

The law is that an educational accreditation is not CP. However, the community is entitled to reimbursement for the education expenses unless: (1) 10 years have passed since the spouse acquired the degree creating a presumption that the community has reaped its benefits; (2) the other spouse also received a professional degree or (3) the education that the spouse receive[s] will lessen the need for spousal support[.]

Here, seven years passed after Wanda acquired the property, so the community is not presumed to have benefitted. Also, there is no indication that Henry received an education.

Wanda may argue that her education helped her open a successful practice and lessened her need for spousal support. Thus, the community should not receive any reimbursement. This will be persuasive only if Wanda can show that she would have been entitled to significant spousal support, absent the degree, which is a dubious proposition considering she had a job prior to giving birth. In other words, it is not clear that she would not have been capable of earning a good income, even without the degree.

A fair solution would probably be to reimburse the community 3/10 of the money it spent on Wanda's education. This would represent amount of benefit the community did not receive, under the 10 year presumption.

Henry then would be entitled to ½ of 1/3 or 1/6 of the expenses spent on Wanda's education degree.

6. Podiatry Practice: Accounting and Goodwill

The issue is whether Wanda's podiatry practice is community property or separate property. Here, Wanda did not inherit a business, but rather opened the business during the marriage. Therefore, the earnings are presumptively all community property since the entire business was a result of her "enthusiasm, skill, and willingness to work long hours."

Pereira and Van Camp accounting principles **do not** seem to apply to this situation. Under Pereira, an independent business's rate of return at 10% is SP, and the rest is CP. This test applies when the growth of a business is primarily the result of a spouse's labor. Under Van Camp, CP is determined by subtracting a community's family expenses from the FMV of the spouse's labor, and the rest of the business value is SP. This test is appropriate when a large part of the business is a result of capital as

opposed to community labor.

Wanda may try to argue that the business is her separate property. She may concede that it grew as a result of her labor, but may argue that the Pereira principles must govern, entit[ling] her to a 10% per annum share as SP.
But, Henry will counter that Wanda started the practice while they were married, and as such, the entire business is a result of her labor. She did not inherit the business, Hen[r]y will argue, but rather opened it during the course of marriage. As such, all of the business earnings are presumptively CP.

Given that Wanda opened the practice after marriage and her labor is solely responsible for the practice, Henry is entitled to half of the practice.

If the court gives Wanda the practice, then it must compensate Henry for half the value. In such a scenario, Henry is also entitled to the value of the **goodwill** of the business. The goodwill is calculated by looking at the total revenue and subtracting the value of Wanda's services as well as cost. The remainder can be attributed to goodwill. In short, if the court decides to grant Wanda control of the business because she is responsible for managing it, it must grant Henry half the value of the business, including the value of goodwill for the foreseeable future discounted to present value.

ESSAY QUESTIONS AND SELECTED ANSWERS

FEBRUARY 2004 CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the February 2004 California Bar Examination and two selected answers to each question.

The answers received good grades and were written by applicants who passed the examination. The answers were prepared by their authors, and were transcribed as submitted, except that minor corrections in spelling and punctuation were made for ease in reading. The answers are reproduced here with the consent of their authors and may not be reprinted.

Question 2

In 1989, Herb and Wendy married while domiciled in Montana, a non-community property state. Prior to the marriage, Wendy had borrowed $25,000 from a Montana bank and had executed a promissory note in that amount in favor of the bank. Herb and Wendy, using savings from their salaries during their marriage, bought a residence, and took title to the residence as tenants in common.

In 1998, Herb and Wendy moved to California and became domiciled here. They did not sell their Montana house.

In 1999, Herb began having an affair with Ann. Herb told Ann that he intended to divorce Wendy and marry her (Ann), and suggested that they live together until dissolution proceedings were concluded. Ann agreed, and Herb moved in with her. Herb told Wendy that he was going to move into his own apartment because he "needed some space." Ann assumed Herb's last name, and Herb introduced her to his friends as his wife. Herb and Ann bought an automobile with a loan. They listed themselves as husband and wife on the loan application, and took title as husband and wife. Herb paid off the automobile loan out of his earnings.

In the meantime, Herb continued to spend occasional weekends with Wendy, who was unaware of Herb's relationship with Ann. Wendy urged Herb to consult a marriage counselor with her, which he did, but Herb did not disclose his relationship with Ann.

In 2003, Wendy and Ann learned the facts set forth in the preceding paragraphs. Wendy promptly filed a petition for dissolution of marriage, asserting a 50% interest in the Montana house and in the automobile. At the time of filing, the Montana bank was demanding payment of $8,000 as the past-due balance on Wendy's promissory note which has been reduced to a judgment. Also at the time of filing, Ann had a $15,000 bank account in her name alone, comprised solely of her earnings while she was living with Herb.

1. What rights do Herb, Wendy, and Ann each have in:
    a. The residence in Montana? Discuss.

    b. The automobile? Discuss.

    c. The $15,000 bank account? Discuss.

2. What property may the Montana bank reach to satisfy the past-due balance on Wendy's promissory note? Discuss.

Answer according to California law.

Answer A to Question 2

2)

1. Rights of Herb, Wendy and Ann

Herb married Wendy in 1989 while both were domiciled in Montana. In 1998 they moved to California, and California law applies here. One year later, in 1999, Herb began having an affair with Ann and moved out, telling his wife he "needed more space" but saw a marriage counselor with Wendy. When she discovered the relationship in 2003, she filed for dis[s]olution.

Community Property

Except as otherwise provided by statute, all property, real or person, whenever situated, acquired by a married person, during the marriage, while domiciled in California, is community property.

Quasi-Community Property

California law holds that real or personal property acquired before the couple was domiciled in California, or real property held outside of California is quasi-community property.

In California, quasi-community property is treated as follows: 1) For purposes of management and control, quasi-community property is treated as separate property; 2) In cases of death or divorce, or the rights of creditors[,] it is treated as community property.

Putative Spouse

Under the putative spouse doctrine, an otherwise valid marriage that is voidable for some reason (here, bigamy) may allow the putative spouse--who reasonably and objectively believes there is a valid marriage--to have rights similar to community property.

Herb moved out in 1999 and began having an affair with Ann, who knew that Herb was married to Wendy, but was told he intended to divorce her. She took Herb's last name, was known as his wife, and took title to a car as his wife. However, Ann knew Herb was still married to Wendy and that the "marriage" was not valid.

The putative spouse doctrine does not apply.

Marvin Relationship

Under the Marvin case, courts may enforce contracts between couples who are not

married, so long as they are not expressly based on performance of illicit sexual acts.

There is no mention of an express contract between Herb and Ann. The only possible "implied" contract is that Ann allowed Herb to move in with her in her apartment because he promised to divorce Wendy and marry her. Such an agreement was explicitly based on a meretricious relationship (committing adultery and divorcing his wife). Public policy requires that this contract not be enforced since it is a contract in derogation of marriage.

There is a small chance courts will enforce the promise as one merely for "housing" since Ann said Herb could live in her apartment. But this is highly unlikely.

The courts will not enforce any promise.

A. Residence in Montana

General Presumption

Under the general presumption, property acquired during the marriage is community or quasi-community property. The Montana residence was acquired during the marriage, with community funds (savings from salaries earned during the marriage). It was acquired in Montana, however, before they moved to California. Therefore, it will be presumed quasi-community.

Titled as Tenants in Common - Presumption (pre-1985)

Prior to 1985, it was presumed that when title was given to a husband and wife as "joint tenants" that they held property as joint tenants. To find community property, the couple had to 1) intend that it be taken as community, and 2) have a writing stating such. Since Herb and Wendy were not married until 1989, this presumption cannot apply.

Post-1985

After 1985, jointly titled property was considered community absent a desire to hold it jointly. No writing was required.

Here, there is nothing to indicate that Herb and Wendy desired the residence to be community. They were not even domiciled in a community property state. However, in such cases where they moved to California afterwards, California law will apply. The courts will probably consider the residence to be community. But this conclusion is not certain.

No Transmutation of Property

After the marriage, the property may be transmuted by a writing. There is no evidence of

such here.

Disposition

Depending on which way the court decides, the residence in Montana may be considered as owned by the community or by Husband and wife as tenants in common. Either way, at dissolution, it will be divided equally between Herb and Wendy.

B. Automobile

While married to Wendy, but during his relationship with Anne, Herb bought an automobile, with a loan, acquiring title with Ann as "husband and wife." Both Herb and Ann signed the loan application. Herb paid off the automobile out of his earnings.

General Presumption

Since the automobile was acquired during his marriage to Wendy, it will be presumed community property.

Possible Exception - Living Separate and Apart

Earnings while living separate and apart are not considered community property.

In 1999, Herb moved out of the dwelling he shared with Wendy and began living with Ann. He told Ann he intended to divorce Wendy, but never took affirmative steps to complete the divorce. During this time, he told Wendy he merely "needed some space" and let her believe he would return at some point. He spent occasional weekends with Wendy, attended marriage counseling with her, and never informed her of his relationship with Ann.

Herb will attempt to show he is living "separate and apart" because he intended the separation to be permanent and was going to divorce Wendy and marry Ann.

Wendy will contend, however, that it was not separate and apart. She will cite Herb's failure to tell her about Ann, his occasional weekends with Wendy, his attendance at marriage counseling, and his act of living this way for 4 years without ever filing for divorce.

The court will probably hold that the spouses were not living separate and apart, and that the earnings of Herb during this time were community property.

Herb and Anne's Title and Husband and Wife - Presumption

Herb and Ann will argue that they took title to car as husband and wife, and that this should control.

Wendy will argue several reasons the car should be community property.

Management and Control - Husband may not make a gift without written consent

As discussed supra, the courts should hold that Herb and Wendy were not living separate and apart, and that his income was community property. While husband and wife generally have equal management and control neither may give property away without the written consent of the other.

Herb attempted to give community funds to Ann by paying for a car and naming her as a joint tenant. This will not be allowed and the car will be considered community property.

Disposition at Divorce.

The car is community and will be divi[d]ed between Herb and Wendy. Ann will get nothing.

C. $15,000 Bank Account

Ann had a $15,000 bank account in her name alone comprised of her earnings while living with Herb. If they were husband and wife, or Herb was a putative spouse, this is presumed community. However, since they are living in a meretricious relationship, the funds were in an account in Ann's name, and were not commingled, they are separate property.

2. What property may the Montana bank reach to satisfy the past-due balance of Wendy's promis[s]ory note?

Prior to marriage, Wendy borrowed $25,000 from Montana Bank and executed a promis[s]ory note for that amount in the bank's favor. At the time Wendy filed for divorce, Montana Bank was demanding payment of $8,000 as the past-due balance on Wendy's promis[s]ory note which has been reduced to a judgment. This is a separate debt.

Time Judgment Was Entered

If the judgment was entered before Wendy and Herb were living separate and apart, i.e., before she filed for divorce, the bank may reach Wendy's separate property or the community.

Herb's Separate Property

Generally, the separate property of one spouse may not be reached to satisfy the separate debt of the other.

Community

If the judgment was reached before legal separation, then community is liable on the debt. However, the bank must first attempt to recover the judgment from Wendy's separate property.

Answer B to Question 2

2)

California is a community property state. All property acquired during marriage is presumed to be community property (CP). All property acquired before marriage or after permanent separation, or by gift, bequest, or devise during marriage, is separate property (SP). All property acquired while parties were domiciled in a non-CP state, that would have been CP if the couple had been domiciled in CA, is quasi-community property (QCP). The source of the funds for a purchase can be traced in determining whether an asset is CP or SP.

At divorce, each CP and quasi-CP asset is split 50-50 between each spouse, and each keeps their own SP.

State of Marriages

This is a complicated situation involving two supposed marriages. Two issues that will determine rights in the property are when H & W's marriage ended, and whether Ann & H have [sic].

The Residence in Montana

Hank (H) & Wendy (W) purchased the Montana home with savings from salaries during their marriage. Salaries acquired during marriage are all considered community property, and thus the home was entirely acquired with CP. In addition, H & W took title as tenants in common, a joint form of title. Under CA law, taking title in a joint form, such as tenants in common, creates a presumption that property is CO [sic]. Since H & W were domiciled outside CA in a non-CP state at the time of the acquisition, the home would be considered quasi-CP because it would have been CP if they had been domiciled in CA.

There is no information indicating the source of payments for principal & improvements, but presumably that has been the earnings of the couple & thus CP. Thus under CA law, the home would be classified entirely as quasi-CP.

<u>Effect of Separation</u>

However, any earnings from either spouse after "permanent separation" are considered to be SP. Here, the issue is whether there was a permanent separation when H moved in with Ann in 1999, or if it occurred in 2003, when W filed for dissolution. If the couple permanently separated before 1999, then any of H's or W's earnings used for principal payments or improvements on the house might be considered to be a SP contribution to a CP asset. Under CA law, such contributions are entitled to reimbursement at divorce.

Permanent separation occurs when the spouses are living permanently apart and when one spouse intends to permanently end the marriage. Here, W will argue that permanent separation did not occur until 2003. Prior to that, although H moved in with Ann, he continued to spend occasional weekends with W, and thus did not permanently live apart from her. Also, the fact that he continued to spend weekends with her is evidence that he did not intend to end the marriage; he was keeping his options open. H, however, will argue that he intended to permanently separate when he moved in with Ann in 2003. He told Ann that he was divorcing his wife, bought a car with Ann, listed themselves as husband & wife, & took title as husband as [sic] wife. He also refused to see a counselor with W [sic]. Hence, he intended to move out permanently.

On balance, because H never filed for divorce & continued to visit W, his intent to end the marriage is not clear; it appears that he was keeping his options open. Hence, permanent separation did not occur until 2003.

In that case, all of the contributions to the house are CP, and the house is classified as quasi-CP to H & W. Ann has no rights to the house on any theory (see discussion below).

The Automobile

The Automobile was purchased with a loan obtained by H & Ann. Thus the source of the loan was one-half H's credit, & one-half Ann's. However, H paid off the loan entirely with his own earnings, however [sic]. Since H was still married to W at the time (see discussion above), H's earnings were CP, because all earnings are considered CP. Thus the car was paid for entirely with CP.

All property purchased during marriage by either spouse is presumed CP. W will argue that since H purchased the car with CP, it remains CP, and thus she is entitled to a 50% interest in it. H may respond, however, that by putting title in his & Ann's name, he considered the car to be a gift from CP to his SP & Ann.

W will respond, however, that, under CA law, a spouse cannot make a gift of community property outside the marriage without the written consent of the other spouse. Here, W certainly did not give her consent. A gift of personal property made without the other party's consent may be reclaimed at any time, with any statute of limitations. Here, since H made the gift to A without W's consent, W may reclaim her share of the community property even after 4 years. In addition, since 1985, no gift changing the character of property has been presumed unless the adversely affected spouse consents in writing. If H asserts that he changed the character of the CP by putting it in his & Ann's name, the transmutation will be unsuccessful because W did not consent in writing.

Here, W will prevail, and the car will be considered as H & W's CP. The issue is A's interest in the car.

Putative Spouse Theory

Although A & H were living together, California does not recognize common law marriage. Thus, any rights Ann may have must be asserted under either a putative spouse theory or contract theory.

A may assert that she is a putative spouse. A putative spouse is one who reasonably believed in good faith that she was married. If the court concluded that one was a putative spouse, all property acquired during the putative marriage is entitled quasi-marital property (QMP) & treated like CP at separation or divorce. Although there has not been a definite decision, if one spouse believed in good faith there was a marriage even the bad faith spouse may be able to treat the property like QMP.

Here, H clearly did not reasonably believe that he was married to A because he knew that he had not divorced W & continued to see her. It would not be reasonable for him to believe that he was married to A.

A, however, may argue that she believed in good faith that she & H were married because [t]hey lived together, she assumed H's last name, they bought a car together, and H introduced her to his friends as his wife. She was unaware of his continued relationship with W. Nonetheless, H had told A when they moved in together only that he "intended" to divorce W & that he had not concluded dissolution proceedings. However, putative spouse status also requires that the belief be reasonable. While any belief of A in the marriage may have been in good faith, a reasonable person would verify that the dissolution proceedings had been concluded. In addition, A & H did not take out a marriage licence or have a wedding ceremony, nor did H tell her that they had a valid common law marriage; he simply suggested they move in together. Consequently, A had a good faith but unreasonable belief in the marriage, and is not a putative spouse. Consequently, none of the property she & Hal acquired while they lived together can be considered quasi-marital property.

Contract Theory

A may be entitled to reimbursement from H on a fraud or breach of contract theory for a share of the car. She may argue that the loan application and title constitute a contract between them [and] that she would have a one-half interest in the car. Although the car appears to be a gift, and none of her money went into the car, she may be able to recover from H on a contract theory.

The $15,000 Bank Account

The $15,000 bank account is in Ann's name alone and consists entirely of her earnings while she was living with H. If they were considered to be putative spouses, then the account would be quasi-marital property, and H & A would each be [e]ntitled to a one-half

share. Since they were not putative spouses, the account is Ann's separate property, and neither H nor W have any rights to it.

Property to Satisfy the Note

W's note is a debt that she entered into before marriage. Debts entered into before marriage are CP. The creditor may attach all CP and the debtor spouse's SP. Quasi-CP is treated like CP for the purpose of satisfying debts.

Here, neither H nor W have any rights to Ann's $15,000 bank account. Thus it may not be attached by any debtor. The car is CP, and thus the debtor may repossess the car to satisfy the judgment. The house is quasi-CP, and thus may be also be entirely attached by the debtor.

However, because the house is in Montana, a California court cannot directly order judgement on the house. W, however is subject to the jurisdiction of the CA court, and the court can therefore order her to transfer title to the house if needed to satisfy the judgment. Thus the debtor can reach the house.

ESSAY QUESTIONS AND SELECTED ANSWERS

JULY 2005 CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the July 2005 California Bar Examination and two selected answers to each question.

The answers received good grades and were written by applicants who passed the examination. The answers were prepared by their authors, and were transcribed as submitted, except that minor corrections in spelling and punctuation were made for ease in reading. The answers are reproduced here with the consent of their authors.

Question 1

In 1998, Henry and Wilma, residents of California, married. Henry had purchased shares of stock before marriage and kept these shares in his brokerage account. The shares in the account paid him an annual cash dividend of $3,000. Henry deposited this income in a savings account held in his name alone.

In 1999, Wilma was hired by Tech Co. Wilma was induced to work for Tech Co. by the representation that successful employees would receive bonuses of company stock options. Later that year, Wilma was given options on 1,000 shares of Tech Co. stock. These stock options are exercisable in 2006, as long as Wilma is still working for Tech Co.

In 2003, because of marital difficulties, Wilma moved out of the home she had shared with Henry. Nevertheless, the couple continued to attend marriage counseling sessions that they had been attending for several months. Later that year, Henry was injured in an automobile accident. Afterwards, Henry and Wilma discontinued marriage counseling and filed for dissolution of marriage.

In 2004, Henry settled his personal injury claim from the automobile accident for $20,000. The settlement included reimbursement for $5,000 of medical expenses that had been paid with community funds.

Henry had a child by a prior marriage and, over the course of his marriage to Wilma, had paid out of community funds a total of $18,000 as child support.

1. When making the final property division in Henry and Wilma's dissolution proceeding, how should the court characterize the following items:
    a. Henry's savings account? Discuss.
    b. Henry's personal injury settlement? Discuss.
    c. Wilma's stock options? Discuss.

2. Should the court require Henry to reimburse the community for his child support payments and, if so, in what amount? Discuss.

Answer according to California law.

Answer A to Question 1

1)

Califor[n]ia is a community property state. All property acquired during marriage is presumptively community property (CP). All property acquired before marriage or after permanent physical separation, or during marriage by gift, will, or inheritance, is separate property (SP). Upon divorce, marital CP assets are distributed 50-50 unless certain exceptions apply.

In determining the time for final property division, the probate court will look at when there was a permanent physical separation and an intent not to resume marital relations. This is when the economic community is considered to be at an end.

Here, the economic community did not end when W first moved out of the home due to marital difficulties, early in 2003. The couple continued to attend marriage counseling sessions, suggesting that they were still hopeful of a possible reconciliation. At the point, they did not have the requisite intent to not resume marital relations. The economic community ended later in 2003 when H & W discontinued marriage counseling and filed for divorce. Only at that time was it clear that there was a permanent physical separation and an intent not to resume marital relations.

1.a. Henry's savings account

Property acquired before marriage is that spouse's SP. All income, rents, and profits from SP earned during marriage is also that spouse's SP. Upon dissolution of marriage, the spouse who owns the SP will take it in its entirety. Although the character of property might change, what was initially SP will remain SP unless there has been a transmutation. No transmutation occurred here.

Henry purchased shares of stock before marriage and kept these shares in a brokerage account. Because the shares were purchased before marriage, they are his SP. The income from these shares, the annual cash divided of $3,000, is also Henry's SP. Furthermore, the income from the shares was deposited into a savings account held in his name alone. This suggests that the funds were not commingled with CP. In addition, it is assumed that W had no rights to withdrawal on the account.

Because the income deposited into H's savings account had as its source the stock he had purchased before marriage, all income in the savings account--assuming it was solely for such income and did not contain any commingled CP funds - - is H's upon divorce. W has no right to the income in the savings account.

b. Henry's personal injury settlement

A personal injury settlement that results from an injury sustained during marriage is presumptively CP. Legal relevance is placed upon when the injury occurred, and not on when settlement was awarded. Upon divorce, however, the injury settlement belongs to the injured spouse: it is treated as the injured spouse's SP. The community is, however, entitled to reimbursement for medical expenses paid with CP when SP was available.

Here, H was injured in an automobile accident that occur[r]ed in 2003, while he was still married to W. As stated above, at the time of the accident, H & W were no longer living together but were still attending marriage counseling sessions. Because there is no indication that H & W intended not to resume marital relations at this point, the economic community was not yet at an end. There was, at this point, no permanent physical separation. Because of these facts, the injury occurred at a time when H & W were still married and the settlement is thus CP during marriage.

On the given facts, the settlement was paid to H in 2004, after H & W had discontinued counseling and had filed for divorce. Thus, the economic community was at an end. Nevertheless, what is legally relevant is that the injury arose during marriage, and not the time the settlement was paid.

At the outset, upon divorce, the $20,000 will be awarded to H as the injured spouse. It is treated as his SP. However, because $5,000 of medical expenses were paid with CP, the community is entitled to reimbursement. Because H received an annual cash dividend of $3,000, it can be assumed that he had $5,000 in his separate savings account at the time the medical expenses were paid. Thus, because CP funds were used to pay his medical expenses at a time when H had SP available, the community is entitled to reimbursement.

The net result is that H will receive $15,000 of the settlement. The community receives a reimbursement of $5,000 which will be divided 50-50 between H & W.

c. Wilma's stock options

Stock options earned during marriage are CP to the extent that CP contributed to them. The court will apply the time rule to determine the pro rata share of contribution of CP and SP. Applying the time rule, a fraction is given whereby the numerator is the number of years that have elapsed between the granting of the options and the date the economic community of the marriage ended. The denominator is the number of years that have elapsed between the granting of the options and the year in which they are exercisable.

Here, the 1,000 shares of Tech Co. stock were awarded to W in 1999. The economic community of H & W ended in 2003. Thus, four (4) years of CP labor creates the numerator. The options are exercisable in 2006. Thus, the denominator will be 7.

The remaining 3 years, from 2004 to 2006, will be treated as W's SP.

Because 4 years out of 7 are attributable to CP, upon dissolution of marriage the community will be entitled to 4/7 of value of the stock options, while 3/4 will be W's SP.

2. Henry's reimbursing the community for his child support payments

Child support payments from a prior marriage are considered a spouse's premarital debt, regardless of whether the payments started before marriage or began during the marriage. Although CP and the debtor spouse's SP are both liable for any premarital debts of the debtor spouse, if CP funds are used during the marriage to make child support payments arising out of a prior marriage, and it is determined that the debtor spouse had available SP funds at the time, then the community may be entitled to a reimbursement upon divorce.

Here, H's child support payments arose out of a prior marriage. H had a child by a prior marriage – not the marriage to W. During the course of his marriage to W, H had paid out of CP funds a total of $18,000 as child support. However, on the given facts, H had SP available to make those payments. He received $3,000 annually in cash dividends from his stocks. Between 1998 and 2004, that amounted to $15,000 ($3,000 multiplied by 5 years). Moreover, he received $20,000 as settlement for the personal injury claim which, although CP at the time received, is treated as his SP upon divorce.

Thus, because CP funds were used to make the child support payments, the community is entitled to reimbursement. H should be required to reimburse the community at least $15,000 which is the amount he had accrued in his personal savings account during the course of the marriage. This amount can be offset from his personal injury settlement claim which will be treated as SP upon divorce. The amount is also $15,000, after the $5,000 has been deducted to reimburse the community. Furthermore, because half of the $5,000 will go to H, that makes an additional $2,500 available to reimburse the community for the child support payments.

In summary, on the given facts, H should be required to reimburse the community for $17,500 for his child support payments.

Answer B to Question 1

1)

California is a community property state. As such, all things acquired between the date of marriage and date of separation are community property and are subject to a 50/50 division upon divorce. Separate property consists of assets acquired before the marriage or after the separation, as well as gifts, inheritances, and devises, and all the profits or rents thereon. Henry and Wilma were married in California in 1998, thus their divorce is subject to the community property system. In analyzing each of their assets it is important to keep in mind the source of the property and whether any subsequent changes in the character of the asset may have transmuted the property from community to separate or separate to community.

Henry's Savings Account

Henry purchased shares of stock before his marriage to Wilma and kept these shares in a brokerage account. These shares were thus Henry's separate property b/c he acquired them before marriage. The shares in the account paid him an annual cash dividend of $3,000, which he deposited into a savings account in his name alone. The cash dividends are also Henry's separate property b/c all rents and profits garnered from separate property are separate property as well. This is true even though there is a presumption that all things acquired between the date of marriage and the date of separation are community property. The rule that rents and profits upon separate property is separate in nature trumps that presumption.

An asset which begins as community property may be transmuted into community property if a spouse manifests an intent to change the asset's character. Here[,] however, Henry has kept both the stock and the cash dividends in an account in his name alone. Therefore, he has not manifested an intent to transmute these stocks from separate to community property. Furthermore, after 1985 a transmutation must be in writing, signed by the spouse losing their interest, and state expressly that they are transmuting the property. Since none of that happened here, everything in Henry's savings account is his separate property.

Personal Injury Settlement

Personal injury settlements awarded during the marriage are community property. However, upon divorce the personal injury settlement will be awarded solely to the injured spouse unless equity demands otherwise. Here, Henry's right to his personal injury settlement arose during the marriage b/c Henry and Wilma were not legally separated at the time he was injured. To be legally separated, the couple must be living physically apart and manifest an intent not to resume the marital relationship.

Here, Henry and Wilma were living apart as of 2003. However, the couple continued to attend marital counseling sessions. Because the couple was still in marital counseling, they obviously did not have an intent not to resume the marital relationship. Rather, counseling suggests that they were trying to work things out. During this time period, Henry was injured. Henry may argue that he did not receive the actual settlement until 2004, at which point he and Wilma had filed for dissolution. However, since his injury and therefore his right to a claim arose during the marriage, the personal injury award will be considered to have arisen during the marriage.

Luckily for Henry, upon dissolution the personal injury award will be awarded to him entirely despite its initial community property characterization, unless equity demands otherwise. Wilma will argue that equity demands otherwise here b/c the community paid for $5,000 of Henry's medical expenses. The community is obligated to pay for all of a spouse's "necessaries." This includes food, shelter, and medical expenses. Because the community had no choice but to pay for Henry's medical bills, a court would probably find that $5,000 of the settlement should be awarded as community property. Under such an analysis, Wilma is entitled to $2,500 (one half of $5,000). Henry is entitled to $2,500 and the remaining $15,000 of the $20,000 as his separate property.

Wilma's Stock Options

If a stock option is awarded during the marriage, then the community has an interest in it. This is b/c stock options are considered incentive compensation, meaning that they reward work currently going on. Therefore, if a stock option is awarded during marriage it is based at least in part upon past and present work in the hope that the employee will keep up the good job. Where the spouse is awarded the stock option during the marriage but exercisability occurs after the date of separation, a special formula must be used to extract the community's interest.

Here, Wilma was awarded the stock option in 1999 in recognition of her success as a new employee for Tech Co. She was married to Henry at that time and thus the community has an interest. Henry and Wilma separated in 2003 and the date of exercisability is 2006 (so long as Wilma is still working for the company.) The formula for extracting the community's interest mandates that the years between the date of the award and the date of separation be used as a numerator while the total number of years between the date of the award and the date of exercisability be used as a denominator. That comes to 4/7. Therefore, the community will be entitled to a 4/7 interest in the 1,000 stocks should they become exercisable.

Another issue is whether Henry can compel Wilma to exercise her stock options. In order to exercise them, Wilma must still be working for Tech Co. in 2006. At some point before 2006, Wilma may decide she no longer wishes to work for Tech Co. and therefore lose her interest. A court will not compel Wilma to continue working for Tech Co. The community merely has an expectancy in the stock options should she decide to eventually exercise them.

Whether the court should require Henry to reimburse the community for his child support payments

Where one spouse owes child support or alimony from a prior marriage, separate property funds should be used first to pay these costs. However, if separate property funds are not available, then the community is responsible for making these payments. Here, Henry had a child by a prior marriage and over the course of his marriage to Wilma he paid out $18,000 in child support from community funds. That comes to $3,600 per year. Since Henry had $3,000 cash dividends coming to him each year as separate property, those funds should have gone to the child support payments first. Only $600 per year of community funds should have been used (for a total of $3,000 during the marriage). Therefore, the community is entitled to $15,000 reimbursement for these child support payments. This means that Henry is entitled to $7,000 and Wilma is entitled to $7,000.

Henry may counter that the community is not entitled to reimbursement b/c he had co-equal powers to spend and incur debt with Wilma over the community property. This is true, however equity still demands that the community receive reimbursement since Henry should have depleted his separate property funds first.

Wilma could also make the argument that one spouse may not unilaterally make a gift of community property and that she may void such gifts while Henry is still alive. This is true. However, child support is more in the nature of an obligation than a gift. Therefore, this argument will be less successful.

ESSAY QUESTIONS AND SELECTED ANSWERS

JULY 2007 CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the July 2007 California Bar Examination and two selected answers to each question.

The answers received good grades and were written by applicants who passed the examination. The answers were prepared by their authors, and were transcribed as submitted, except that minor corrections in spelling and punctuation were made for ease in reading. The answers are reproduced here with the consent of their authors.

Question 6

Husband and Wife married in 1997 in California. Neither of them brought any significant assets to the marriage, and they were both employed. Husband and Wife agreed that Husband should go to law school after they had saved up some money. Husband put his earnings in a savings account in his name alone. Wife deposited her earnings into a joint checking account in both of their names, which was used for their living expenses. Husband had a child support obligation from a previous marriage. Every month, Husband paid his child support by check from the joint checking account.

Husband began law school in 1998. Wife continued to work to support the couple. Husband took out a student loan to pay his tuition. Husband graduated in 2001 and obtained his law degree. He passed the bar exam and got a position with a large law firm.

In 2004 Husband became a partner in the firm. Husband's partnership earnings were substantial. He paid off his student loan using these earnings. Although the actual value of Husband's share of the firm's goodwill was substantially greater, the partnership agreement provided that its value was $3,000 for purposes of valuation as marital property in the event of a dissolution of a partner's marriage.

In 2006, Husband and Wife filed for dissolution of marriage.

1. Is the community entitled to reimbursement for
(a) The child support? Discuss.
(b) The payments on the student loan? Discuss.

2. Does the community have an interest in
(c) Husband's law degree? Discuss.
(d) The goodwill in Husband's law firm and, if so, is the community bound by the firm's valuation? Discuss.

Answer according to California law.

Answer A to Question 6

California is a community property state. All amounts earned through the community labor of married California residents are presumptively community property, which means that they are owned together, equally, by the husband and wife (or by the domestic partners). All items earned through gift, bequest or devise to an individual spouse remain that spouse's separate property. Community property continues to accrue until the end of the economic community, which occurs with physical separation and an intent not to resume the marriage. Certain presumptions arise from form of title, and CP may be transferred to separate property and vice versa.

Community's Reimbursement Claims

Child Support

The community remains liable for all credit obligations of each individual spouse, whether acquired before or during the marriage. Thus, Husband's ("H") child support obligations, although they arose before marriage, may still be satisfied from the community property jointly owned by the couple. However, by statute, the community is entitled to reimbursement for child support payments that arise from a prior marriage of one of the spouses, if that spouse's separate property was available at the time to satisfy the obligation. Here, H and W married when neither of them had any significant assets, although they were both employed. If H had no available separate property at the time he made the child support payments, those obligations were legitimately paid out of community funds, and the community has no right to reimbursement. The payments were made from H and W's joint checking account, which is funded entirely with W's earnings. Since W's earnings are CP, the payments on the child support were made with CP (by H writing checks drawing on the joint checking account).

Savings account in H's name alone

The fact that H opened a savings account in his name alone does not defeat the presumption that his earnings remain community property. Title in one spouse's name, if the name on the bank account can be considered title, does not prohibit tracing to the source of the funds. It may, in certain circumstances, be evidence of a gift from the community to that spouse. However, when the spouse takes title in his or her own name, no inference of a gift will arise. Also, it may serve as a bar to the other spouse's premarital creditors, if the non-debtor spouse's CP earnings are placed in the separate account and the debtor spouse has no access to it. However, here it is H who has the obligation. Thus, because the separate savings account was funded only with H's earnings, it will be deemed to be community property, since the earnings of one spouse through labor are community property. And, because any profit from community property remains community property, whatever interest H has earned will remain CP. Of course, the facts do indicate that H and W were both employed when the entered the marriage. Thus, it is possible that some of the earnings H used to fill the savings account were his premarital earnings. H might attempt to trace some of the value of the savings

account to those funds. However, where assets have been commingled, they are presumptively community property and W will have a hard time asserting the amount of separate property in H's account. If she were able to trace, the community would be reimbursed to the extent that those separate property funds (if any) were available to pay for the child support.

Transmutation and the savings account

In order for the separate account to constitute a transmutation of CP to H's separate property, the agreement would need to be in writing, with W (as the adversely affected) spouse expressly conveying the interest to H and signing the writing. Here, H's name on the bank account does not constitute a transmutation.

Thus, community property was properly used to pay for the child support payments, even if they were a premarital obligation of H. Because H had no apparent separate property available when the payments were made, the community is not entitled to reimbursement.

Payments on student loan

A loan constitutes community property to the extent that the lender relied on community property in making it. Here, H decided to go to law school and take out loans while he was married to W. The lender presumably relied on the future earnings of H and W's current income, all community property at the time. Thus, the "intent of the lender" makes this a community loan. Moreover, H used his earnings as a lawyer to pay off this loan, thus it was paid for entirely with community property. By statute, the community is entitled to reimbursement, with interest, when community funds are used to pay for the education of one spouse which greatly enhances that spouse's earning capacity. Here, H's law degree has resulted in him becoming a lawyer at a large law firm, with a presumably generous salary. Thus, the degree has greatly enhanced H's earning capacity. The community is therefore entitled to reimbursement for the amount of the student loan used for the education itself (not for the amount used for ordinary living expenses), with interest. However, if H can establish an equitable defense, reimbursement will not apply.

Equitable defenses to community reimbursement

Where the community has already substantially benefited from the increased earnings due to one spouse's education, there will be no reimbursement to the community at divorce. Substantial benefit is presumed where the community has benefited from the increased earnings for 10 years. Here, H began working in 2001, as an associate presumably, and became a partner in 2004. The couple is now seeking a divorce in 2006. Thus, at most, it has benefited from H's earnings for 5 years, which does not constitute a substantial benefit.

Also, where community funds have been used to pay for an education for the other spouse as well, the community is not entitled to reimbursement. Here, W worked the entire time H was in law school, and did not benefit from an education. Thus, this

defense will not apply.

Finally, where the degree has lessened the obligations of one spouse to pay for support of the educated spouse post-divorce, reimbursement may not apply. Here, it is unclear what W's earning capacity is. If she is extremely well paid (a CEO perhaps) then she might still be under an obligation to pay spousal support to H post-divorce, and this obligation might be lessened by H's ability to earn a lawyer's salary. However, there are no facts indicating what W makes, so this defense presumably does not apply.

Community's Interest in H's Law Degree and the Goodwill of H's Law Firm

Law degree

By statute, professional degrees earned by one spouse during the marriage are not community property, although as noted above the community may be entitled to reimbursement for the cost of acquiring that education. That one spouse worked to pay for the education is irrelevant to the ownership of the degree. The reimbursement interest does not amount to a community interest in the degree itself – meaning an interest in the present discounted value of the future earnings attributable to the degree. Thus, the law degree remains H's separate property going forward, and the community is entitled only to reimbursement with interest for the cost of acquiring the degree.

Goodwill

Goodwill is the value of a business over the expected normal rate of return on the capital invested in that business. In essence, it constitutes the intangible value of the business' reputation above and beyond the raw liquidation value of the business. When the goodwill is generated by community labor, it is a community property asset. Here, H's share of the goodwill was earned entirely while he was married to W. Thus, the goodwill itself is a community property asset.

Valuation and the Partnership Agreement

The valuation of goodwill occurs by one of two methods. First, it can be valued by capitalizing the future stream of income to a present fixed sum (according to varying calculations). Second, it can be valued by looking to the "market price" of the interest. The latter is established by bona fide offers to purchase the business or concern. Here, the partnership agreement of H's firm specifies that the value of H's share in the firm's goodwill is valued at $3,000, but only "in the event of a dissolution of a partner's marriage." However, the community is not bound by this valuation, because it does not constitute a valid market valuation of H's goodwill interest. Buy/sell options in a partnership agreement created by the relevant spouse's firm will not control the valuation of that spouse's interest at divorce. This is because of the obvious risk of abuse inherent in such a valuation. The partner-spouse could agree with his or her other partners to create a very low valuation only for purposes of divorce, in order to deprive the non-partner spouse of his or her rightful share of the partner spouse's interest. Here, that seems to be exactly what has occurred, especially given that the agreement expressly provides that it only applies when one of the partners gets divorced. Thus, the $3,000

valuation will not control, and the court will apply the capitalization (or some other) method.

Valuation of a SP business

The Van Camp and Pereira doctrines would not apply here, since H did not enter into the marriage with a SP business interest. Thus, to the extent the law firm is considered a business, and H considered an owner, H's interest will be entirely community property, as noted above.

Answer B to Question 6

Community Property

California is a community property state. All property acquired during marriage is presumed to be community property (CP). All property acquired before marriage or after legal separation is considered separate property (SP). Further, all property acquired by either spouse during marriage by gift, bequest or devise is that spouse's separate property. Upon dissolution of marriage, all community property assets are subject to equal division in kind unless statute or policy requires otherwise.

(1)(a) Is the community entitled to reimbursement for the child support payments?

Child Support

Child support obligations from a previous marriage are considered the separate property obligation of the acquiring spouse. However, during marriage, community funds may be reached to satisfy any payments. Upon divorce, the community is entitled to reimbursement for any child support payments made with community property funds when separate property funds were available.

Here, H had a child support obligation from a previous marriage. Every month he paid his child support by check from the joint checking account held in both H and W's names. The checking account contained W's earnings during marriage; thus the checking account contained community property, because all earnings during marriage are considered community property. The issue is whether H had separate property funds available at the time the payments were made.

Bank Account titled in H's name alone – transmutation?

The fact that a bank account is titled in one spouse's name alone does not automatically rebut the community property presumption. Any change to the character of a community property asset after 1985 is required to be in a signed writing, specifically indicating that the nature of the asset is being transmuted.

Here, H opened a bank account in his own name in 1997; however, he deposits into that account his earnings. All earnings during marriage are presumed to be CP. There is no indication that there was a written transmutation of these funds from CP to H's SP; thus the CP presumption cannot be rebutted and all of H's earnings in his savings account will be considered CP.

Also, neither H nor W brought any significant assets to the marriage. Thus, it does not appear that H had any SP assets available at the time the CP funds were used to pay the child support payments. As such, the community will not be reimbursed for any payments made.

(1)(b) Is the community entitled to reimbursement for the payments on the student loan?

Debts

Generally, all debts acquired during marriage are considered community property. However, if it was the intent of the lender to only look to satisfaction of the debt by one spouse's SP, then the debt will be a SP debt.

Here, H took out educational loans to obtain a law degree. Any educational debt acquired during marriage is CP; however, upon divorce, it will be assigned to the acquiring spouse. Thus, it is likely that the lender only looked to H's SP to satisfy the debt knowing that if H and W were divorced, only H would be liable on the debt. However, there are no specific facts to support this argument.

Education

Any education acquired during marriage is the SP of the acquiring spouse. However, upon dissolution of marriage, the community is entitled to reimbursement for any payments made to finance the education if the education substantially increased the spouses' earning capacity unless (1) the community has already substantially benefited from the education; (2) the other spouse also received a community funded education; or (3) obtaining the education offset the need for spousal support.

Here, H obtained a law degree. H began law school in 1998 and W continued to work to support the couple. H took out a student loan to pay his tuition. H graduated in 2001, passed the bar and got a job with a big law firm. Being a lawyer substantially enhanced his earning capacity because in 2004, he became a partner and his earnings were substantial. H paid off his student loan using these earnings. Because H used his earnings during marriage to pay off the loan, the loan was paid off with community funds. Thus, the community financed H's education. As such, the community is entitled to reimbursement unless an exception applies.

Has the community already benefited?

If the spouse has had the education for more than 10 years, there is a presumption that the community has already benefited from the education and no reimbursement is required. Here, H got his law degree in 2001 and H and W filed for dissolution in 2006. Thus, H has only had the job for 5 years at the time of dissolution and the presumption will not apply.

On the facts, no other exception applies. W did not receive a community funded education, and there is no indication that without the education, H would have needed substantial child support. Thus, the community is entitled to reimbursement of the community funds spent to pay off H's student loan.

(2)(c) Does the community have an interest in H's law degree?

Education

Any education acquired during marriage is the SP of the acquiring spouse. As discussed above, the community is only entitled to reimbursement for any community funds spent to finance the education if the education substantially enhanced the spouses' earning capacity. Further, educational debt remaining at the time of dissolution is assigned to the acquiring spouse.

Here, there is no debt remaining on H's education. The community will take no interest in H's education, but as explained above, will be reimbursed for the funds expended to pay off H's loans.

(2)(d) Does the community have an interest in the goodwill of H's law firm and, if so, is the community bound by the firm's valuation?

Goodwill

All assets acquired during marriage by the labor and efforts of a spouse are community property, and goodwill is no exception. The goodwill of a professional practice is a community asset. Goodwill is the value of the continued patronage to the practice. It is the value of the business that is not derived from personal skill or the value of the assets of the business. It can be valued by expert testimony or by capitalizing the excess earnings of the practice.

Here, H will argue that no valuation is necessary because the partnership provides that its value was $3000 for purposes of valuation as marital property in the event of a dissolution of a partner's marriage. However, this argument is likely to fail. In a similar case, the California Supreme Court held that any valuation provided for in a partnership agreement may be considered in valuing the goodwill of a professional practice, however, it is not conclusive as to the value. Further, the court indicated an unwillingness to let partners contract with each other in order to defeat the community property system.

Thus, the court may consider the agreement as evidence of value, but ultimately will allow W to put on evidence of an expert to explain what the goodwill of the business is really valued at. This will be considered CP and subject to equal division in kind.

ESSAY QUESTIONS AND SELECTED ANSWERS
FEBRUARY 2008
CALIFORNIA BAR EXAMINATION

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Question 5

Harvey and Fiona, both residents of State X, married in 1995. Harvey abandoned Fiona after two months. Harvey then met Wendy, who was also a State X resident. He told her that he was single, and they married in State X in 1997. They orally agreed that they would live on Harvey's salary and that Wendy's salary would be saved for emergencies. They opened a checking account in both their names, into which Harvey's salary checks were deposited. Wendy opened a savings account in her name alone, into which she deposited her salary.

Harvey and Wendy moved to California in 1998. Other than closing out their State X checking account and opening a new checking account in both their names in a California bank, they maintained their original financial arrangement. In February 1999, Harvey inherited $25,000 and deposited the money into a California savings account in his name alone.

In 2004, Wendy was struck and injured by an automobile driven by Dan. Harvey and Wendy had no medical insurance. Wendy's medical bills totaled $15,000, which Harvey paid from the savings account containing his inheritance. In 2005, Wendy settled with Dan's insurance carrier for $50,000, which she deposited into the savings account that she still maintained in State X.

Very recently, Harvey learned that Fiona had died in 2006. He then told Wendy that he and Fiona had never been divorced. Wendy immediately left Harvey and moved back to State X. The savings account in State X currently contains $100,000. Under the laws of both State X and California, the marriage of Harvey and Wendy was and remained void.

1. What are Harvey's and Wendy's respective rights in:
    a) The State X savings account? Discuss.
    b) The California checking account? Discuss.
    c) The California savings account? Discuss.

2. Is Harvey entitled to reimbursement for the $15,000 that he paid for Wendy's medical expenses? Discuss.

Answer according to California law.

Answer A to Question 5

California is a community property state. Property acquired during the marriage is community property (CP), while property acquired before marriage, after the end of the marital economic community or by gift or inheritance is separate property (SP). When couples who are not domiciled in California acquire property in a non-community property state and then later relocate to California, such property is treated as quasi-community property (QCP) if it would have been CP had the couple been domiciled in California at the time of acquisition.

In order to determine the character of any asset, the court will look at (i) the source of the asset, (ii) any actions of the parties that may have changed the nature of the asset, and (iii) any presumptions affecting the asset.

With these general principles in mind, I now turn to the specific items of property.

1. Harvey's and Wendy's Respective Rights

Prior to determining Harvey's (H) and Wendy's (W) respective rights in the various items, it is important to determine the nature of their marital relationship, as well as the effect of their oral premarital agreement. Putative spouses are entitled to "quasi-marital" property (QMP) rights, while unmarried cohabitants' property rights are governed by contract. QMP rights are treated the same as CP.

Putative Spouse

In order to be considered a putative spouse, the spouse must have a good faith reasonable belief that he or she is lawfully married. While H knew that he had never divorced Fiona prior to marrying W, W had a good faith reasonable belief that she was lawfully married to H because H told her that he was single, and it appears that they married in 1997. Thus, W qualifies as a putative spouse. The putative marriage, and QMP rights accrue, until such time as the putative spouse learns that he or she is not lawfully married. Here, the facts indicate that H only told W in 2006 that he and Fiona had never divorced, at which time she learned that she was not lawfully married. Thus, the putative marriage existed from 1997 until 2006, at which point it ended when W learned that she was not lawfully married, and QMP rights ceased to accrue.

Oral Arrangement between H and W

While generally parties may orally agree how to handle their affairs, premarital or marital agreements and agreements changing the character of marital property rights must be in writing. Thus, although H and W orally agreed that they would live on H's salary and save W's for emergencies, this "oral transmutation" of their QMP rights is invalid. Further, if their oral agreement was akin to a prenuptial

arrangement, it would only be valid if (i) it was in writing, (ii) each had disclosed to the other the full nature of his or her property, and (iii) [each] was represented by independent counsel. None of these elements appear to be present. W may try to argue that she should still get the benefit of the oral arrangement, however, because her savings account has $100,000, and she was the putative spouse and that H will benefit under QMP rights; however, the court can find that even if W's State X savings account was to be "saved for emergencies", this still indicates an intent to use it for the benefit of the putative marital economic community (and not keep it as W's SP). Thus, the court should not give effect to the oral agreement between H and W regarding the treatment of their QMP. All of the QMP should be treated as CP (for property acquired while domiciled in California) and QCP for property acquired while domiciled in State X.

a. The State X Savings Account

The source of the $100,000 State X savings account is W's earnings and [a] $50,000 settlement with Dan's insurance carrier (resulting from a 2004 injury W suffered when she was struck and injured by an automobile driven by Dan). Earnings during marriage are CP, which would be considered QMP in the present case. Further, the $50,000 settlement would also be considered CP, or QMP in the present case, because the cause of action arose during the putative marriage and H was not the tortfeasor. Thus, the entire State X savings account is QMP.

The court will then look to the actions of the parties to determine if they have changed the character of the asset. W may then try to argue that because the bank account is in her name alone that it is her SP. However, taking title in one spouse's name alone does not defeat the QMP interest. Nothing indicates that H intended the savings account to be W's SP, only that they intended it to be available for "emergencies." Plus, as discussed above, the court will not enforce the oral agreement regarding the treatment of the QMP. Thus, the State X savings account is QMP, and should be treated as QCP (for earnings deposited while not domiciled in California) and CP (for earnings and tort settlement deposited while domiciled in California).

Upon the end of the putative marriage (similar to divorce), QCP and CP are treated the same and each spouse generally has an equal undivided ½ interest in the QCP/CP. However, an exception to this general rule exists for tort settlements and judgments, which the court will award solely to the injured spouse unless the interests of justice require otherwise. Here, nothing indicates that it would be unfair to let W keep the $50,000 tort settlement, subject to reimbursing H for the $15,000 expended (see below). Thus, of the $100,000 in the State X savings account, W will take $50,000 (as the injured spouse taking the tort settlement), subject to reimbursement of $15,000 to H, and will take $25,000 as her QCP/CP interest and H will take the $25,000 as his QCP/CP interest.

b. The California Checking Account

The source of the California checking account is H's salary checks (and presumably the funds from their State X checking account, which were also H's salary checks). As noted above, earnings are CP and thus the source of the California checking account is CP/QCP and would qualify as QMP.

The court will then look to see if the parties have taken any actions to change the character of the assets. Here, H and W have done nothing to defeat the putative marital economic community interest in the property. As discussed above, the oral agreement will be given no effect. Moreover, even though the oral agreement of the parties won't be given effect, the oral agreement is evidence of an intent that H and W intended H's earnings to be used to benefit the putative marital economic community. Further, H and W took title to the checking account in both their names. Thus, the California checking account is QMP.

As noted above, as QMP will be treated like CP upon end of the putative marriage. Thus, each of H and W has an undivided ½ interest in the California checking account.

c. The California Savings Account

The source of the California savings account is H's $25,000 inheritance. Inheritance is SP. Thus, the California savings account is H's SP. Because the parties have taken no actions that would change the nature of H's SP to CP (or QMP in this case), the California savings account remains his SP. This is further evidenced by the fact that H took title to the account in his name alone. Upon the end of H's and W's putative marriage, H takes the remaining funds in the California savings account as his SP and W has no rights in the California savings account.

2. Reimbursement to Harvey of $15,000 for Wendy's Medical Expenses

When a spouse (or putative spouse) expends SP on the medical expenses of the other spouse, he or she is entitled to reimbursement to the extent that the community had sufficient funds available or that the debtor spouse had sufficient SP available at such time. Here, it appears that H expended $15,000 of his SP, while the putative marriage may have had sufficient QMP funds to handle the "emergency" medical expenses in the State X savings account (which now has $100,000 [only $50,000 of which is the insurance settlement]), or even in the California checking account (QMP), for which we have no information. To the extent that there was sufficient QMP available or that W had sufficient SP available at the time H paid the $15,000 of medical expenses out of his SP, H is entitled to reimbursement.

Answer B to Question 5

General community property rules

California is a community property state. Under California law, all property acquired during marriage is presumed to be community property (CP). All property acquired before marriage, after marriage, or during marriage through inheritance, bequest, or devise is presumed separate property (SP). Three factors determine the characterization of property as CP or SP: the source of the asset; what actions the parties took that may have changed the asset's character; and what special presumptions apply, if any, that might change the asset's character.

Quasi-community property

Under California law, quasi-community property (QCP) is any property acquired during marriage that would have been CP had the acquiring spouse lived in California at the time of acquisition. The QCP designation generally only becomes relevant at divorce or death. At divorce, QCP is treated like CP; at death, the surviving spouse has a ½ interest in the deceased acquiring spouse's QCP, but a nonacquiring spouse who predeceases an acquiring spouse has no rights to QCP.

Here, because H and W acquired property while married but living outside California, any such property that would otherwise be designated as CP will be designated as QCP.

W's status as putative spouse

California does not recognize common-law marriage, but recognizes putative spouses. For a party to claim putative spouse status, the aggrieved party must have been acting under the good faith belief that she was married during the period claimed. As soon as the party becomes aware that the marriage is invalid, or upon dissolution of the relationship, her rights as a putative spouse terminate. California treats all property acquired during putative marriage as quasi-marital property (QMP), which is treated the same as CP for purposes of disposition at death or divorce.

Here, W was under the mistaken good-faith belief that she and H were validly married. H told her he was single, and they had some kind of marriage that led W to believe they were married. Thus, between 1997 and "very recently," W will have putative spouse rights from their putative marriage through the time she found out that H and Fiona had never been divorced. Thus, all property acquired by W and H during this period that would otherwise be QCP or CP under California law will be designated as QMP.

It should be noted that while some states bar a non-innocent putative spouse from any recovery of QMP, California law permits both spouses to recover their respective shares of QMP notwithstanding fraud or bad faith of one of the parties. Thus, if QMP should be treated as CP, H will recover his share accordingly.

1. Harvey and Wendy's rights

a. State X savings account

Source: W's QMP earnings

W opened a savings account in State X during her putative marriage to H. She deposited her salary earned during her putative marriage into this account. Because all earnings acquired during marriage are presumptively community property if the couple lives in California, this property would be QCP/QMP and treated as CP for purposes of divorce.

Form of title

W would argue that because she opened the savings account in her name alone, the form of title should make the deposits her SP, rather than community earnings. If W could prove that H knew that she took title in her name alone and consented to it, such a showing could strengthen a presumption that H intended to make a gift to W of community earnings. However, H would successfully rebut any potential gift presumption through evidence of their oral agreement that the earnings were to be used "for emergencies"; i.e., this was intended to be a community nest egg in the event of an emergency.

Oral transmutation

A transmutation is an agreement by a married couple to change the form of property from SP to CP or vice versa. Any oral agreements by a married couple before 1985 are admissible to prove transmutation; however, after 1985 a writing is required. Here, because the oral agreement is one that supports an argument for CP, W would not be able to use this evidence to strengthen her SP assertion. Additionally, because the property is presumptively CP under California law, H would not need to introduce this oral agreement as evidence of transmutation.

Married woman's special presumption

The married woman's special presumption states that any property taken in a married woman's name alone before 1975 is presumed to be her SP. However, here, no married woman's special presumption applies, because the property was taken in W's name after 1975. Additionally, the presumption does not apply to bank accounts.

Personal injury award

As a general rule a personal injury settlement for a cause of action that arose during the marriage is considered CP unless the other spouse was the tortfeasor.

However, upon divorce, the proceeds are awarded to the injured spouse unless the interests of justice require otherwise.

Here, W was injured by Dan, a non-spouse, and ultimately received a $50,000 settlement, which she deposited into the State X savings account in 2005. H would argue that the settlement was QMP, and thus should be split equally between H and W. However, as noted, at divorce, the $50,000 will be awarded to W unless the interests of justice require otherwise. Here, no facts indicate that the interests of justice require otherwise, so W should be entitled to the $50,000.

Disposition

Thus, W should be entitled to $50,000 of the State X savings account unless the interests of justice require otherwise. W and H each have a ½ QMP/CP interest in the remaining $50,000, so they should get an additional $25,000 each.

b. The California checking account

State X earnings

H's earnings in State X occurred during his putative marriage to W; thus, these earnings would be considered QCP under California law, characterized as QMP, and treated as CP upon dissolution of his relationship with W.

California earnings

H's California earnings also occurred during his putative marriage to W; thus, these earnings would be considered CP under California law, characterized as QMP, and treated as CP upon dissolution.

Form of title

Here, there is no form of title to rebut the presumption that all marital earnings are CP. The bank account was in joint and equal form, and as such, strengthens the presumption that his was a community asset.

Presumptions

No special presumptions apply.

Disposition

Because all of the contents of the California checking account were either QCP or QMP under California law, they will be treated as CP upon dissolution to the extent the money was earned during H and W's putative marriage. Thus, H and W are entitled to a ½ share each of the balance of the account as of the date of W's departure/the dissolution of the putative marriage.

c. The California savings account

H's inheritance

H inherited $25,000, which he deposited in the California savings account. Property acquired during marriage through inheritance is considered the inheriting spouse's SP; thus, the $25,000 is considered H's SP.

Form of title: In H's name alone

H kept his inheritance separate in an account in his name only and did not commingle any QMP earnings during the putative marriage. Thus, the form of title combined with the source of the account funds will be sufficient to sustain a finding that the property remained H's SP at all times.

H's expenditures for W's medical bills

H expended $15,000 of his SP for W's benefit during their putative marriage. The effect of this expenditure on H's potential rights to reimbursement is discussed below. For purposes of the remainder of H's California savings account, this expenditure will have no effect on the characterization of the asset.

Presumptions

No special presumptions apply.

Thus, H retained an SP interest in the California savings account and is entitled to the entire contents. Because H expended some of his SP for community benefit, he may be entitled to reimbursement from the community. Regardless, H takes the remaining $10,000 as his SP.

2. H's potential right to reimbursement for W's medical expenses

As a general rule, all debts incurred during marriage are community obligations. Where one spouse expends SP to pay a community obligation, he may be entitled to reimbursement from the community if he did not intend a gift and there were sufficient CP funds available at the time, and no other special presumptions apply.

Here, H expended $15,000 of his SP to pay W's medical expenses. H will argue that he is entitled to reimbursement from the community because W's expenses were a community obligation.

To the extent CP funds were available at the time to pay W's medical expenses, H will be entitled to reimbursement from the community.

However, a spouse's SP may be reached to the extent the other spouse incurs expenses for "necessaries" during marriage. The contributing spouse remains liable for expenses for "necessaries" until the dissolution of the marriage.

Here, H would argue that because W's savings account was expressly created as a community asset "for emergencies," and because the balance after receiving W's settlement deposit was $100,000, sufficient CP funds existed at the time W incurred her medical expenses and he should be reimbursed for his SP expenditures.

In the alternative, H would argue that because W subsequently received a $50,000 settlement, which was considered QMP during marriage and which would more than cover her direct medical expenses, the interests of justice should require that $15,000 of that $50,000 should be treated as the community's property to pay her medical expenses and he should be reimbursed.

Thus, under either argument, because sufficient QMP funds existed at or near the time of W's medical expenses, H should be entitled to reimbursement for his $15,000 payment of W's medical expenses.

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ESSAY QUESTIONS AND SELECTED ANSWERS
FEBRUARY 2010
CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the February 2010 California Bar Examination and two selected answers to each question.

The answers received good grades and were written by applicants who passed the examination. The answers were prepared by their authors, and were transcribed as submitted, except that minor corrections in spelling and punctuation were made for ease in reading. The answers are reproduced here with the consent of their authors.

Question 6

Herb and Wendy, residents of California, married in 2001. Herb worked as an accountant. Wendy was an avid coin collector who hoped someday to turn her hobby into a profitable business. Prior to marriage, they had entered into a prenuptial agreement providing that each spouse's wages would be his or her separate property.

On Wendy's birthday in 2002, Herb gave Wendy a drawing by a famous artist. Herb paid for the drawing with $15,000 that his parents had given him. Wendy hung the drawing in their bedroom.

In 2003, Wendy opened CoinCo, a shop specializing in rare coins. She capitalized the business with a $10,000 inheritance that she had received when her grandfather died. Wendy worked at the shop alone every day. Customers appreciated her enthusiasm about coin collecting and her ability to obtain special coins at reasonable prices. Over time, Wendy learned that she had acquired a number of highly valuable coins. There was also a renewed interest in coin collecting due to the discovery of several boxes of old coins found buried in the area.

Although Wendy's services at the shop were worth $40,000 per year, she took an annual salary of $25,000. She also paid $5,000 in household expenses from the business earnings each year.

In 2008, Herb and Wendy separated, and Wendy filed for dissolution of marriage. At that time, CoinCo was worth $150,000, and the drawing was worth $30,000.

In 2009, before trial of the dissolution proceeding, Wendy was disabled by a serious illness and had to be hospitalized. She closed CoinCo while she was in the hospital, and the value of the business fell to $100,000 by the time of trial. Her hospital bill was not covered by health insurance.

In the dissolution proceeding, Wendy claims that the prenuptial agreement is valid and Herb claims that it is not.

What are Herb's and Wendy's respective rights and liabilities in:

1. The drawing? Discuss.

2. CoinCo? Discuss.

3. The hospital bill? Discuss.

Answer according to California law.

Answer A to Question 6

California is a community property state. All property acquired during marriage is community property (CP). Property acquired prior to marriage or after permanent separation, and any property received during the marriage by gift, bequest , or devise, is separate property (SP). In order to determine the character of property, we must trace back to the funds used to acquire the property, then apply any special exceptions or conditions under the law. Both spouses are entitled to a one-half share of CP. At divorce, the CP is divided equally unless there are special considerations that apply.

1. The drawing

To determine the character of a piece of property we trace back to the funds used to acquire it. Here, we are told that H paid for the drawing with $15,000 that his parents gave him as a gift. Property acquired during marriage as a gift to one spouse is SP; therefore the $15,000 was SP, and by tracing we determine that the drawing was SP at the time it was purchased.

Transmutation

Prior to 1985, the character of property could be more easily changed or transmuted from SP to CP or vice versa. After 1985, however, any transmutation of property had to be in writing to be valid. An exception to this is where a spouse gives the other spouse a gift of relatively insubstantial value, in which case the gift between spouses can be transmuted from CP to SP or from SP to CP or even from one spouse's SP to the other spouse's SP.

Here, we are told that the drawing was by a famous artist, and that H purchased it in 2002 in honor of W's birthday for the substantial sum of $15,000. We are also told that Wendy hung the drawing in the couple's bedroom. Under these facts, the drawing was of substantial value and would not ordinarily come within the transmutation exception for gifts of insubstantial value. But we are also told that it was bought on Wendy's birthday, H gave it to her, and W hung it in their bedroom. Those facts appear to show an intent

that the painting was either given to the community from H's SP, or possibly even given to W as her SP, but hanging the painting in their bedroom looks more like a potential transmutation from H's SP to CP. However, because the drawing was clearly valuable and there was no writing, no transmutation occurred. The painting remained H's SP at the time of permanent separation.

End of economic community upon permanent separation.

A marriage ends upon dissolution/divorce, but the economic community of a marriage ends upon permanent separation, where the couple separates with the intent to not reconcile and to stay permanently separated and dissolve the marriage. Here, we are told that H and W separated in 2008, and W filed for dissolution of marriage at that time. Therefore, the economic community ended in 2008. We are also told that in 2008 the painting was worth $30,000. Because there was no transmutation, the painting was still H's SP, and now worth $30,000.

2. CoinCo

Separate property business enhanced by community labor. Where a SP business is enhanced by community labor during marriage, for the purposes of dissolution the courts will use one of two formulas in order to determine the CP's interest and share in the SP business.

Pereira: Where the SP business growth is due predominately to the spouse's labor and abilities, the Pereira method is used. Under Pereira accounting, the SP business spouse is entitled to the original principal value of the business, plus an annual rate of return calculated at 10%, both of which are SP. The remaining value of the business is CP.

Van Camp: Where the value of the SP business derives mostly from the character and nature of the business itself, the Van Camp method of accounting is used. Under Van Camp, the community is entitled to the reasonable salary value of the spouse's labor,

minus any mount received by the community, and minus any community expenses paid. All else is SP.

Pereira analysis:

Here, we are told that we can trace the beginning of CoinCo in 2003 to W using a $10,000 inheritance. This inheritance is SP; therefore CoinCo is a SP business belonging to W. We are also told that W had prior to marriage been an avid coin collector, therefore she had skill and expertise used to increase the value of the business. We are also told customers appreciated her enthusiasm about coin collecting and her ability to obtain special coins at good prices and had in fact obtained highly valuable coins. We are also told that after permanent separation with W became ill, the value of CoinCo fell from $150,000 in 2008 to $100,000 in 2009, because W was not available to lend her skills to the business. All of these factors point to W's skill and expertise as being the reason for CoinCo's success, and point to a Pereira analysis. Under Pereira, the initial value of CoinCo of $10,000 is SP, and 10% per year from 2003 when it started to 2008 upon permanent separation is $1,000 per year or $5,000. Therefore $15,000 would be W's SP, and the remainder would be CP. At permanent separation CoinCo was worth $150,000, so $135,000 was CP, and H would be entitled to half of that. We are told that in 2009, CoinCo's value fell to $100,000. If that figure is used, then we deduct the $15,000 SP and the $85,000 remaining is CP.

Van Camp analysis:

On the other hand, we are also told that there was a renewed interest in coin collecting due to the discovery of old coins found buried in the area. This would point to CoinCo being inherently valuable because of the type of business it was, and not entirely due to W's expertise skill and labor. If a court decided that was the predominant factor, then under Van Camp analysis we are told the W's services at CoinCo were worth $40,000 per year. Over five years that is $200,000. We are told that W took an actual salary of $25,000 per year, and W also paid $5,000 per year of household community expenses. So the community already received $125,000 of salary over five years from 2003 to 2008 and $25,000 in expenses totaling $150,000. Under Van Camp, the community is

still entitled to $50,000, the difference between the $200,000 value and the $150,000 actually received. The initial $10,000 investment is W's SP. We are told that by the time of 2009 divorce trial the value of CoinCo fell to $100,000. Thus $50,000 of that is CP and the rest is SP.

Prenuptial agreement:

A prenuptial agreement is valid so long as it is in writing. Here we are told that prior to marriage W and H entered into a prenuptial agreement providing that each spouse's wages would be his or her SP. The agreement is valid; therefore W's wages from CoinCo are her SP and the community is not entitled to them. Therefore, the above Van Camp analysis is altered by the prenuptial agreement. The $125,000 in salary will not be credited to the community, but the expenses (which are not mentioned in the prenup) will still be credited. Thus under Van Camp and under the prenup wages of W are not credited to the community.

This does not affect the Pereira analysis which is not based on wages. Overall, the facts show that the increase of value of CoinCo was due primarily to W's skill so because Pereira does not take wages into the analysis there is no change under Pereira. H will want Pereira used, and W will want Van Camp used, because it is based on her wages, which are SP under prenup. But a court is likely to apply Pereira.

3. The hospital bill

Debts after permanent separation

After permanent separation the economic community ends. Any debts that are incurred by either spouse post-separation are SP debts, and creditors will have to go after the SP of the spouse who incurred the debt. An exception exists, however, for debts related to the necessities of life, such as food, clothing, shelter, and, arguably, health care expenses. In that event, a creditor may go after the debtor spouse's SP, the CP, and also the SP of the other spouse.

Here, we are told that in 2009, after the permanent separation but before the divorce trial, W was disabled by a serious illness and in hospital, and that her hospital bill was not covered by insurance. Because the hospital bill is for a necessity of life and they are not divorced yet, the hospital can go after W's SP, the CP, and H's SP for this necessity of life debt.

Answer B to Question 6

California is a community property state. In California, property acquired during marriage is presumed to be community property (CP). Property acquired before marriage and after legal separation is deemed separate property (SP). Additionally, property acquired by gift, bequest and devise is also SP.

The name of the title is not determinative of the property's characteristics. Courts may trace the funds used to acquire the property to determine the characteristics of the property. With these things in mend, we can understand how a court will assess the distribution of the following assets.

Prenuptial agreement

The determination of the distribution of assets at the divorce of Wendy and Herb all depend on the validity of the prenuptial agreement. A prenuptial agreement is an agreement that allows [a] party to contract out of California community property law. To be valid, there must be a writing signed by both parties, each of whom are represented by independent counsel, there must be a valid waiver in writing, a full disclosure of all assets, and a minimum of 7 days before the parties sign the agreement. Additionally, the parties must have the capacity to enter such [an] agreement, including no undue influence from either party. Also, it must be voluntary. Here the only facts we are given was that in 2001, Herb and Wendy married in California. Prior to their marriage a prenuptial agreement was entered into. The agreement stated that wages of each spouse would be his or her separate property. However, at the divorce proceedings, Wendy claims that the agreement is valid while Henry argues it is not. Without facts demonstrating the validity of the agreement, the following distribution analysis will show the results of the distribution with or without a valid prenuptial agreement.

1. The drawing

Items acquired during marriage are presumed to be CP unless tracing the assets or actions of the parties shows otherwise. Here, on Wendy's birthday in 2002, she

acquired a drawing from a famous artist. Wendy acquired this painting from her husband Herb. Herb paid $15,000 dollars for the painting using money his parents gave him. As stated above, property and money received as a gift is the SP of the party receiving the gift. When Herb acquired the painting, tracing shows that it was his SP. However, in 2002, as a birthday present, Herb gave the painting to Wendy. Wendy will argue that since she received the property as a gift, it is presumed that gifts become the SP of the receiver.

However, in 2008 the painting was worth $30,000 dollars. Herb will argue that the property should still be his property because it was an invalid transmutation of his SP to Wendy's SP.

Transmutation

Transmutation is the doctrine of transferring one person's SP into another person's SP. After 1985, stricter requirements were necessary for property to be validly transmuted. After 1985, in order to successfully transmute the property a party needed to show there was 1) a writing, 2) signed by the party who is giving up the SP and 3) expressively states the transmutation of the property. Under these facts we do not see a valid transmutation under the 1985 documents.

Here, in 2002, Herb gave the drawing as a birth gift. We are not given any other facts. If Wendy can show that she was given the drawing and was given a birthday card, that said possibly "I know you love this drawing, now it's yours! Love, Herb" we may have a valid transmutation. The card in itself is a writing, as would be his statement explaining the gift. Additionally, people usually sign birthday cards. Since we do not get the facts stating this or anything like this happened, the painting was invalidly transmuted and Herb will be able to trace the drawing back to the Parents' $15K gift. Also, the actions of the parties, Wendy hanging the drawing in the bedroom does not show the property was SP. Wendy will have to return the painting.

Pre-nup?

Since this drawing was not purchased using either party's earnings, the pre-nup has no effect on the distribution of the drawing.

2. CoinCo

The next issue is the distribution of the CoinCo business. Since, under California law, earnings acquired through the effort, intelligence, and skill of either part is deemed CP, the validity of the pre-nup is vital to the distribution of Coinco.

Invalid pre-nup

The following analysis presumes that a court will believe Hank and find that the 2001 pre-nup is invalid.

The courts use two tests to determine the property interests of a self-employed company owned and worked out by a spouse during marriage. A court may use either the Pereira analysis while Wendy would desire the Van Camp if it is shown that the pre-nup is invalid.

Pereira Analysis

Under Pereira, courts conclude that the company's value is based upon the effort, hard work, and skill of the working spouse. Since we are working with the assumption of an invalid pre-nup, the earnings by a spouse during marriage are presumed CP. Under Pereira, the working party keeps their SP and receives a reasonable rate of interest on the investment (10%) multiplied by the years worked. Here, the company was capitalized by a $10K inheritance of Wendy that she received when her grandfather died. As described above, in heritance is SP.

Herb will argue that her business thrived because of her work, enthusiasm and her ability to collect special coins as reasonable prices. If the court believes this to be true,

under Pereira, Wendy would be entitled to her initial $10K + 10% of $10K multiplied by her years worked, which look to be 5 (2003 – 2008). This number would go to Wendy's SP and the rest would go to the CP estate.

Van Camp

Under Van Camp, courts conclude that it was not the work of the spouse, but certain circumstances outside their control resulted in the increase of the business value. Here, Wendy will argue that because of a discovery of boxes of old coins, a renewed interest in coin collecting caused her business to boom. She will argue that she was lucky since she always wanted to start a coin business but fortunately came in at the right time. If a court believes this to be the reason why the business flourished, a court uses a different formula than the one used above. Under Van Camp, the community receives a reasonable salary minus whatever was already received minus household expenses multiplied by the number of years worked. The rest would go to the SP of the working spouse.

Under these facts, a reasonable salary would be about $40K per year. Wendy only took out $25K per year and also spent $5K in household expenses per year. So $10K would be multiplied by the 5 years she worked, resulting in $50K going to CP. Since at the time of dissolution the company was worth $100K, Wendy would receive $50K as SP and her half of CP resulting in her receiving $75K.

Court Discretion

Although Wendy will argue for a Van Camp analysis and Herb will argue for a Pereira analysis, a court has the discretion to choose whichever one they like. Courts will look to whichever method is intrinsically fair to both parties in making their determination.

Valid pre-nup

If the court finds that the pre-nup is valid, as Wendy claims, the property will be distributed differently. Since the pre-nup rebuts the presumption that the earnings during marriage are CP, Herb may not recover anything under either test.

Presumably, income derived from one's SP is deemed to also be SP.

Under Pereira, courts conclude that the company increases based upon the skill and effort of the other party. Here, since the skill and effort are considered earnings, Herb would not receive anything under Pereira. Both the initial down payment as well as the earnings acquired during Wendy's years working would be her SP and would result in her obtaining the full $100K. Since Wendy would be able to argue that income from the company is both her earnings and investment, Herb would acquire nothing.

Also, under Van Camp, Herb would get nothing. Just like the analysis above, since the company was financed by SP and her earnings under the Pre-nup are SP, the entire $100K would be characterized as SP.

Goodwill

Herb's last ditch effort is to argue that goodwill is a community asset. Goodwill is a community property interest that increases customer retention in a business. Here Herb will argue through her enthusiasm Wendy created goodwill for the community. However, goodwill is created by the skill and effort of the working party. As stated above this is deemed part of one's earnings. Under the pre-nup, earnings are one's SP. Herb has no valid claim on receiving CP money for goodwill.

If the pre-nup is valid, Herb has no claims of CoinCo.

3. The Hospital Bill

Traditionally, a party has no financial obligations after legal separation and/or divorce. Legal separation is defined as the mutual intent to no longer continue marital relations with a physical separation. Here, the facts stated that in 2008, Herb and Wendy did separate. Without other facts, it is presumed that their separation had the required intent.

An exception to the statement above states that a spouse's SP and CP is liable for necessities acquired by the other spouse. Here, in 2009, Wendy became disabled and had to be hospitalized. The facts also state that this occurred before the dissolution proceeding. Because Herb and Wendy are not divorced, Herb retains some liabilities as it pertains to Wendy's hospital bills.

Since Wendy's bill was not covered by insurance, 3 types of property may be used for fulfill the hospital obligations. First, Wendy's SP may be used. Additionally, since medical bills are deemed a necessity by California law, both the CP and Herb's SP may be used to fulfill this obligation. If in this instance Wendy is not able to use her SP to pay the bill Herb is liable to use his own property.

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ESSAY QUESTIONS AND SELECTED ANSWERS
JULY 2010
CALIFORNIA BAR EXAMINATION

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Question 6

In 2000, Harry and Wanda, California residents, married. Harry was from a wealthy family and was the beneficiary of a large trust. After their marriage, Harry received income from the trust on a monthly basis, and deposited it into a checking account in his name alone. Harry remained unemployed throughout the marriage. Wanda began working as a travel agent. She deposited her earnings into a savings account in her name alone.

In 2003, Harry and Wanda purchased a vacation condo in Hawaii. They took title in both their names, specifying that they were "joint tenants with the right of survivorship." Harry paid the entire purchase price from his checking account, which contained only funds from the trust. Harry and Wanda orally agreed that the condo belonged to Harry.

In 2004, Harry purchased a cabin in the California Mountains to use when he went skiing. He paid the entire purchase price of the cabin from his checking account, and took title to the cabin in his name alone.

In 2005, Wanda commenced a secret romance with Oscar. During a rendezvous with Oscar, Wanda negligently operated Oscar's car, causing serious personal injuries to Paul, another driver.

In 2006, Wanda received an e-mail advertisement inviting her to invest in stock in a bioengineering company. She discussed the investment with Harry, who thought it was too risky. Wanda nevertheless bought 200 shares of stock, using $20,000 from her savings account to make the purchase. She put the stock in her name alone.

In 2007, Harry and Wanda separated. Shortly thereafter, as a result of the car accident, Paul obtained a money judgment against Wanda.

Harry and Wanda are now considering dissolving their marriage. The condo and cabin have increased in value. The stock has lost almost all of its value.

1. In the event of a dissolution, how should the court rule on Harry's and Wanda's respective rights and liabilities with regard to:
    a. The condo in Hawaii? Discuss.
    b. The cabin in the California Mountains? Discuss.
    c. The stock in the bioengineering company? Discuss.

2. What property can Paul reach to satisfy his judgment against Wanda? Discuss.

Answer according to California law.

Answer A to Question 6

California is a community property state. There is a presumption that all property acquired during marriage is community property (CP). In general, community property is defined by what it is not – it is not separate property. Separate property (SP) is all property acquired by either spouse before marriage so after dissolution or acquired by inheritance. The rents and income from SP are also considered SP.

In the event of a divorce, CA requires all CP to be distributed equally between both spouses. This applies to all CP property as well as CP liabilities. Each item of CP should be distributed 50/50, unless economic circumstances warrant a different distribution. At divorce, the court has no jurisdiction to award SP. Each spouse keeps his or her own SP.

In determining whether an asset is classified as CP or SP, one must look to the source of the asset. One must also determine if either spouse has taken any action to recharacterize the property or if any presumption applies to the property.

1. Rights and Liabilities of Harry (H) and Wanda (W)

In determining the rights of H and W in all of the property at dissolution, each asset must be classified as either CP or SP.

(a) The Condo in Hawaii

Funds used to Purchase the Condo

The condo in Hawaii was purchased in 2003, while H and W were married. Since this was acquired during marriage, the general CP presumption is raised. H will attempt to rebut this CP presumption by tracing the purchase price of the condo. The condo purchased with money from H's checking account. This checking account contained only income from H's trust. These funds came from his inheritance only and (as mentioned above), money received during marriage from inheritance is characterized as SP and income from SP is characterized as SP. This checking account was never commingled with any CP funds and thus, all of the money in the account (the income

and any principal) would be SP. Further, H evidenced his intent to keep his money as his SP since he took title to the account in his name alone. Thus, the condo was purchased with SP funds.

Titled as "Joint Tenants with the Right of Survivorship"

Purchasing an item of property with SP funds does not alone classify the item as SP. One must also look to the title taken on the property. In this case, H and W took title as "joint tenants with the right of survivorship." In Lucas, the CA court held that any taking of property in joint and equal form evidences an intent to take the property as CP. The CA legislature passed a statute known as the anti-Lucas statute, which has been in effect since 1984. Under this law, joint title is still considered CP (as in Lucas) but the court dictated how SP purchase money must be treated. Absent any written agreement between the spouses, the SP proponent will not have [been] apportioned into the joint tenancy property. If no written agreement is established, the SP proponent will only be able to assert a right to reimbursement for the amount paid towards the purchase price.

Therefore, in this case, although SP was used to purchase the condo, the condo would be characterized as CP. H and W orally agreed that the condo was H's SP, but this agreement was not in writing and is thus unenforceable under the anti-Lucas statute. In the event of dissolution, H and W will each own a 1/2 interest in the condo and, thus, they will each be entitled to 1/2 of its appreciation amount. H will be reimbursed from the community for his SP contribution to the purchase price. Thus, he will be reimbursed the entire price of the cabin when it was purchased since his SP paid the entire amount.

(b) The Cabin in CA

The cabin was purchased in 2004 while H and W were married and, thus, the general CP presumption is raised. Again, H would attempt to rebut the CP presumption by tracing the purchase funds back to his SP checking account (discussed above). H paid for the entire purchase price of the cabin with SP funds.

He would also show his intent to keep his SP interest by showing that he took title to the property in his name alone. Taking title in one's name alone is not enough to rebut the

CP presumption but when this is coupled with a purely SP purchase price, the SP proponent will be able to rebut the presumption and prove the property is SP.

Therefore, at dissolution, the cabin will be characterized as H's SP and it, along with its increase in value, will be awarded entirely to H. Since H did not use his cabin for any business purpose during the marriage, the community does not receive any ownership interest as a result of its increase in value during the marriage.

(c) The Stock

Funds used to Purchase the Stock

In 2006, W purchased stock in a bioengineering company. This stock was purchased during marriage and is presumed to be CP. The source of the funds used to purchase the stock came from W's savings account. The money in this savings account came entirely from W's earnings as a travel agent. The earnings of each spouse during marriage are considered CP. Thus, the money in the savings account was all CP.

W would attempt to show the money was actually her SP since the account was titled in her name alone. But, as mentioned, title in one spouse's name alone is not enough to evidence a SP interest. The SP proponent must also be able to trace the funds to SP monies or must be able to show that the other spouse gave a gift of his or her CP share. In this case, there is no evidence that H intended to gift away his CP interest in W's earnings. Further since 1985, any transmutation, which is any agreement to change the character of property during the marriage, must be in writing. There is no writing to evidence the intent to transmute these earnings from CP to W's SP. Therefore, the stock is considered all CP.

Management and Control of CP

Under CA CP laws, each spouse is given equal rights to manage and control the CP, unless a specific exception applies. Exceptions are realized for the sale of real property, for any gift of CP, or for any sale of the necessities within the home (such as furniture). If any of these exceptions do not apply, either spouse is permitted to unilaterally make decisions regarding the CP.

In this case, H might argue that he told W the investment was too risky and thus, the liability for the loss in the stock value should be hers alone. But this would not be a winning argument since W was permitted to unilaterally spend CP monies. None of the exceptions above apply to this situation. Stock is not real property. This was not a gift since W paid $20,000 for the stock and the stock is not a necessity of the home.

Therefore, at dissolution, the liability for the loss in the stock value should be distributed equally between H and W.

Breach of Fiduciary Duty

H might also claim that W breached her fiduciary duty when she purchased this stock. In all marriages in CA, both spouses are considered fiduciaries of each other. They owe each other a duty of care and loyalty regarding CP funds. One spouse is permitted to make decisions regarding purchases and sales, but the spouse will breach his or her duty if he or she is grossly negligent or reckless in some CP transaction.

H will argue that W was at least grossly negligent when she refused to listen to his complaints regarding the purchase of the stock. He told her it was too risky and she was grossly negligent when she ignored this fact.

W would counter-argue that this was just a typical investment and there was no gross negligence. First, she had no knowledge that this stock was actually risky. All she had was H's opinion that the stock was too risky but this is not enough to show she was grossly negligent when she decided to purchase it. Second, even if she had some knowledge that the stock was risky, this is typical in most stock purchases. No stocks are guaranteed to make money and in almost all stock purchases, the buyer takes some sort of risk. This inherent risk does not equal gross negligence at all times. Since this was not a grossly negligent or reckless use of CP funds, H cannot prove that W breached a fiduciary duty and H cannot collect any losses in the value of the stock from W.

2. Property to satisfy Paul's Judgment

In general, a creditor of either spouse can reach the CP of the couple and the creditor spouse's SP to collect on the debt. This general rule applies to debts incurred during marriage as well as debts incurred prior to the marriage.

For certain kinds of judgments, there are rules that dictate how the creditor can collect from the spouse. For tort judgments, the rules depend on whether or not the tortfeasor spouse committed the tort while she was benefiting the community. If the tort was committed while the spouse was engaging in activity that benefits the community, the creditor must collect from the couple's CP first and then, if necessary, collect from the tortfeasor's SP. If the tort was committed while the spouse was not engaged in activity that benefited the community, the tort creditor must first collect from the tortfeasor's SP and then collect from the couple's CP if necessary to satisfy the entire judgment.

In this case, W committed a tort against P while she was married. This tort was committed while W was having a secret rendezvous with her lover Oscar. Thus, W was not engaging in an activity the benefited the community at this time. H had no knowledge of this activity and this activity certainly cannot be said to have benefited H. Therefore, P must first collect from W's SP to satisfy his judgment and then, if necessary, he can collect from the couple's CP. At no point is he permitted to collect from H's SP.

H may argue that this debt should be considered entirely W's SP debt because P obtained the judgment against W after H and W separated. Thus, he would argue that the debt was incurred after separation, when the community is no longer liable. H's argument would not be a winning argument. In determining liability for a tort, the liability will attach at the time the tort is committed, not at the time the judgment is actually obtained. Thus, a court will determine that W incurred this liability in 2005 when she injured P, not in 2007 when P finally obtained the judgment.

Thus, since this debt was incurred during marriage, the rules discussed regarding the order of satisfaction apply. P must first collect from W's SP but, at dissolution, W has no SP. Then, P must collect from the couple's CP. Here, the only property

characterized as CP is the stock and the Condo in Hawaii. P can reach the stock (even though it has almost no value) and then he can reach the increased value of the condo. In reaching the condo, he cannot collect from the share that H is entitled to for reimbursement of the purchase price.

Answer B to Question 6

Introduction

Because Harry and Wanda are residents of California, California law is applicable. California is a community property state. All property acquired during marriage by either spouse is presumptively community property. All property acquired by either spouse before marriage or after permanent separation, or by gift, will, or inheritance, is presumptively separate property. In determining the characterization of an asset, a court will look to the source of funds used to purchase that asset. A court will also consider any actions taken by the parties that may have affected its characterization, as well as any presumptions of law that affect the asset's character. Finally, the mere fact that an asset has changed form will not change its character. With the above principles in mind, we will now look at each asset in turn.

The Condo in Hawaii

Source

The source of funds used to purchase the vacation condo in Hawaii was from Harry's checking account. Harry's checking account is entirely composed of money that he received from a family trust. The money received from this family trust is considered a gift or inheritance. Thus, the money is his separate property. In addition, he did not commingle his separate property with the funds of the community, which might have given rise to a presumption that family expenses paid from those assets are community property. The title to the condo was taken in both spouses' names, and was taken as a joint tenancy with a right of survivorship. Thus, it was taken in joint and equal form.

Presumption: Joint and Equal Form

Where joint and equal title is taken to property which was acquired through a spouse's separate property funds, the Lucas and Anti-Lucas principles apply. The property itself is presumptively community property. Upon death, Lucas applies to hold that absent an express agreement to the contrary, the separate property which was used to acquire title in the property in question will be deemed to have been made as a gift to the community. Thus, the donor spouse has no claim of ownership or reimbursement. Upon divorce, the principles of Anti-Lucas apply. These provide that absent some

express agreement to the contrary or express wording in the deed, upon dissolution of marriage, the spouse who gave separate property toward the purchase of an asset that was acquired in joint and equal form is entitled to reimbursement for the down payment, improvements, and principal, but not an ownership interest.

Actions: Oral Agreement that the Condo Belonged to Harry

Spouses may make agreements or gifts that transfer property from one form to another, whether from separate to community or community to separate. This is called a transmutation. Since January 1, 1985, all transmutations must be in writing, signed by the party to be adversely affected, and must clearly indicate that a change in characterization is intended. In this case, the agreement between Harry and Wanda that Harry would own the condo was made orally. Thus, it is not a valid transmutation and this agreement did not change the characterization of the condo.

Disposition: Community Property with Right of Reimbursement

In this case, the parties are considering dissolution of marriage. Anti-Lucas will apply. This means that upon divorce, the condo is community property and Harry can claim a right to reimbursement for the purchase price of the vacation condo, since he paid this purchase price with his separate property funds. However, he is not entitled to an ownership interest in the condo. Therefore, any increase in the value of the condo belongs to the community and will be split evenly between Harry and Wanda.

The Cabin in the California Mountains

Harry purchased the cabin in the California mountains with money from his checking account. The money in his checking account was derived solely from the trust that he inherited. Because these funds are derived from inheritance, they were his separate property. He took title to the cabin in his name alone. Separate property includes all assets purchased entirely from separate property, unless some presumption such as that of joint and equal form applies. Because Harry did not take title in any joint and equal form, a presumption of a gift to the community does not arise under Lucas or Anti-Lucas. Thus, the cabin is Harry's separate property. Upon dissolution of marriage, Harry alone will take the entire cabin, including any increase in its value.

The Stock in the Bioengineering Company

Source

Wanda purchased stock in a bioengineering company using $20,000 from her savings account. The money from her savings account was derived from her work as a travel agent. Salary that either spouse earns during the time of marriage is community property. Although Wanda kept her earnings in a separate account in her name alone, this does not change the fact that the funds are community property. Form of title is generally inconclusive. This fact might have been relevant if Harry had sought to use those funds to pay his own premarital debt. However, since that is not the case, then funds are community property. Thus, the stock was purchased with community property funds and will be presumptively community property.

Action: Title Taken in Wanda's Name Alone

Wanda took title to the stock in her name alone. Generally, the fact that a spouse takes title to an asset in his or her name alone does not change the presumption of community property, if the funds used to purchase that asset were community funds. In this case, the fact that Wanda took title to the stock in her name alone does not make the stock her separate property, unless it can be shown that some gift was intended. Wanda will likely argue that Harry intended to make a gift of the stock to her as her separate property, since he did not think the investment was a good idea and therefore did not want the investment for the community. However, it is unlikely that Harry's disapproval meant that he intended to make a gift of community assets to purchase the stock. Instead, Harry did not want Wanda to purchase the stock at all. Thus, he did not make a gift to her of the stock, and it will therefore remain as community property.

Action: Purchase without Harry's Permission

Under the equal management powers doctrine, either spouse alone may encumber, sell, or otherwise dispose of community assets. Thus, the fact that Wanda purchased the stock without Harry's permission will not change its characterization. In addition, Harry is not necessarily entitled to reimbursement for the community property that Wanda used to purchase the stock, since she had the power to use that money to purchase stock.

Duty of Loyalty

Each spouse owes a duty of the highest good faith, loyalty, and fair dealing to the other spouse. Neither may gain a financial advantage at the expense of the other. Also, neither may make a grossly negligent or reckless investment of the community's funds. In this case, Harry thought that the stock was too risky. If the stock was in fact so risky that investing in it was grossly negligent and reckless, Wanda will be said to have breached a duty of loyalty to her husband. If that is the case, she may have to reimburse him for his share of the community funds that were used to purchase the stock. However, the mere fact that Harry thought the investment was risky does not alone make it a reckless investment. Thus, it is unlikely that Wanda breached the duty of loyalty to her husband.

Disposition: Community Property

Because the stock was purchased with community funds and form of title did not change this, the stock is community property. It and its loss in value will be equally divided upon dissolution of marriage.

What Property can Paul reach to Satisfy his Judgment against Wanda?

Tort Liability

Where a spouse commits a tort during the marriage, the injured party can reach community assets and the separate property assets of the tortfeasor spouse. The order in which these items will be used to satisfy the obligation will depend on whether the tortfeasor spouse committed the tort to "benefit" the community. In this case, Wanda committed the negligent act while meeting Oscar, with whom she was having a secret romance. Having a secret romance with another man was not an action taken to benefit the community. Thus, the tort was not committed for the benefit of the community. This means that Paul may first reach Wanda's separate property, and then Paul may reach community property. Paul may not reach any of Harry's separate property, because Harry is not personally liable, and this is not a contract for necessities.

The Condo

The condo is community property upon divorce. However, where title is taken in the form of a joint tenancy with the right of survivorship, during marriage each spouse will own a 1/2 separate property interest in this property. This means that creditors of one spouse can only reach the 1/2 separate property interest of that debtor spouse. In this case, Paul may reach only Wanda's 1/2 separate property interest in the condo. This will be the first item that will be used to satisfy Paul's judgment, since it appears to be the only asset that is Wanda's separate property. Paul may not reach Harry's 1/2 separate property interest in the condo.

The Cabin

The cabin is Harry's separate property because it was purchased with his separate property funds and title was not taken in joint and equal form. Thus, Paul may not reach the cabin, since Harry is not personally liable and this is not a contract for necessities.

Harry's Checking Account and Trust Fund

Harry's checking account and his trust fund are his separate property. They may not be used to pay Paul.

The Stock

The stock is community property. Thus, once Paul has exhausted Wanda's separate property, if he has not satisfied his judgment he may proceed to use the stock as well.

Wanda's Savings Account

The savings account in Wanda's name is community property. Thus, it may be reached to satisfy Paul's judgment.

ESSAY QUESTIONS AND SELECTED ANSWERS
JULY 2011
CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the July 2011 California Bar Examination and two answers to each question that were written by actual applicants who passed the examination after one read.

The selected answers were assigned good grades and were transcribed for publication as submitted, except that minor corrections in spelling and punctuation were made for ease in reading. The answers are reproduced here with the consent of their authors.

Question 6

In 2003, Wendy and Hank were engaged to be married. They discovered that the $10,000 monthly income Wendy derived from a trust fund would terminate upon her marriage or upon her reaching the age of 25, whichever came first. Therefore, they decided to postpone their wedding until Wendy's 25th birthday, in 2006, and instead began to live together.

Also in 2003, Wendy and Hank agreed that Wendy would pursue a master's degree in education and that Hank would quit his job and stay home, taking care of the household chores. Wendy opened a checking account in both of their names, into which she deposited her $10,000 monthly trust income. Wendy used funds in the checking account to pay living expenses for Hank and herself. Wendy also used funds in the checking account to buy a new car. She put title to the car in both of their names.

In 2006, Wendy and Hank married. Wendy's $10,000 monthly trust income terminated. Afterwards, Wendy began teaching at a local college.

In 2008, Wendy learned that her compensation was less than that of her male counterparts and made a claim against the college.

In 2009, Wendy separated from Hank and filed an action for dissolution of marriage. Shortly afterwards, she settled her claim against the college in return for additional salary in the amount of $10,000 per year for the next three years.

Unbeknownst to Wendy, Hank had run up a gambling debt to a casino during their marriage. At the time of their separation, Hank owed the casino $50,000.

Upon dissolution of marriage, what are Wendy's and Hank's rights and liabilities with respect to:

1. The car? Discuss.

2. The $30,000 in additional salary under the settlement? Discuss.

3. The $50,000 owed to the casino? Discuss.

Answer according to California law.

Answer A to Question 6

California is a community property state. The community property system applies to people who are legally married or registered as domestic partners. All property acquired before or after marriage or separation and all property acquired by gift, bequeath, devise, or descent is presumptivelt the acquiring spouse's separate property (SP). All other property acquired during marriage is presumptively community property (CP). This question involved the dissolution of a marriage. Upon dissolution, each spouse is entitled to all of their separate property and community property should be divided equally between them.

The Car

CP Principles do not apply

Unmarried cohabitants are not included under the CP system, even if they are engaged and plan to marry. However, under Marvin, cohabitants may have some rights under contract theories where there are agreements between the parties regarding income and expenses.

Here, H and W were engaged and postponed their wedding until she turned 25 so W would continue to receive payments under her trust fund. They then moved in together. As unmarried cohabitants, they are outside the CP system even though they were engaged and had planned to married. There must be a valid marriage for any property to be CP. However, they may have contract rights under Marvin.

Contract Formed between H and W

An enforceable contract may be found between cohabitants when there is an agreement supported by consideration of each party and the consideration is more than sexual services.

H will argue that there was an enforceable agreement between him and W. H will show the joint bank account that the trust funds were deposited and the use of the trust funds to pay living expenses as evidence of this agreement. H may also argue that the agreement constitutes a valid contract as his household duties were consideration for

W's contribution of her income to support the couple so that W could attend school and earn her master's degree. This argument would likely be effective in most courts as it seems to be established under the facts that there was a meeting of the minds and the consideration on both sides was valid.

Interests in the Car under a valid agreement

Where there is a valid agreement between cohabitants, they may be able to acquire property interests under its terms.

W purchased the car while she and H were cohabitating before marriage. W paid for the car with her trust income, which is undisputably her SP as she has not yet married. The car was title in both H and W's names and the funds used were from a joint bank account. While certain title presumptions would control under CP system, here the interests in the car are governed by principles of contract and equity. H will argue that he has an interest in the car because he and W agreed that she would attend school and he would stay home and they would live off of her trust income until it expired when she turned 25. Further, the car was purchased with funds from a joint bank account to which H would have had a right to withdraw, showing an intent that the funds benefit both H and W. Further, W put the car in both names, confirming her intent that there be a joint interest. Therefore, H should be given an equitable interest in the car. W will argue that while they agree to use her income to support themselves, she never intended to agree to give H any interest in the car that would exist beyond their relationship and only put his name on the title for convenience while they were living together. At dissolution, then, the car should be treated as a gift and not as something to which H as an interest. However, because there is clear evidence of an agreement regarding the use of the trust income to support H and W in exchange for H's household duties and it was W who opened a joint checking account and deposited the trust funds there and then put the car in H and W's name, H will likely be found to have some interest in the car, likely one-half of its now depreciated value as the agreement and form of title indicate a desire to share equally, despite the fact that the purchase funds are traceable to W's SP.

The $30,000 Salary Under the Settlement

Termination of the Marital Economic Community

The marital economic community is formed at marriage and determinates upon permanent separation, which occurs when the parties live separate and apart and at least one spouse does not intend to return to the marriage.

W separated from H in 2009 and filed for dissolution of marriage. This evidences an intent not to return to the marriage and thus constitutes permanent separation and terminates the marital economic community.

What to the proceeds of the settlement replace?

Any labor performed by a married person is considered community labor and any salary earned during marriage is CP. However, salary earned following permanent separation is SP. Courts have found that when funds received following permanent separation are intended to replace wages that were earned during marriage, those funds are CP because they are traceable to community labor.

Here, W began working at a local college in 2006, after marriage to H. All salary earned prior to separation is therefore CP. In 2008 she discovered she was being paid less than male colleagues and filed suit. In 2009 and post-separation, she settled for $10,000 additional salary for the next three years. H will argue that the settlement is CP because it is intended to replace the salary that W should have been paid and was earning during marriage. W will argue that because the funds are going to be distributed as post-separation salary, they are her SP. Here, replacement analysis favors H and will result in the CP characterization as the settlement related to a claim for wages that should have been paid during marriage, as the claim was filed during marriage, and therefore are intended to replace CP earnings.

Distribution of Settlement Funds

In cases of personal injury settlement, courts have classified the settlement proceeds for injuries occurring during marriage as CP but strongly favor awarding such funds to the injured spouse upon dissolution in a rare exception to the presumption that CP should be divided equally.

W will likely try an analogize to these cases, arguing that the discrimination was an injury during marriage and even if the proceeds are CP she is entitled to them upon dissolution as they are compensation for her injuries. This argument will likely be unsuccessful. Personal injury funds are awarded because they typically compensate for the injured spouse's present and future suffering and medical expenses and as such should be given to the injured spouse both because he or she will have an continued increase need and because the injury was personal to the spouse. Further, even with personal injury damages, the award will be divided to the extent equity requires, including when there has been loss to the community. Here, the loss compensated was entirely the community's as W was underpaid for her community labor and thus did not receive the salary she should have, which would have been entirely CP. Therefore, H and W will each have a one-half interest in the proceeds at dissolution.

Rights of H and W to the settlement

The settlement is CP and so H and W each have a right to one-half the amount, or $15,000. This amount could be paid to H now by giving him a CP share in an amount that accounts for his $15,000 or by imposing a remedial trust on the funds such that H and W are each entitled to one-half of the payments over the next three years.

H's Gambling Debt

Liability During Marriage

During marriage, debts acquired before or during marriage are community debts and any CP and the acquiring spouse's SP will be liable for the debt. Therefore, whether H acquired the debt entirely during marriage or not, the CP would have been liable during marriage.

Liability Upon Dissolution

At dissolution, the community property is divided and thus no longer exists. While CP is divided equally, courts have more discretion in the division of liabilities acquired during marriage. Where one spouse has acquired a debt and the debt was not for the benefit of the community, it would likely be assigned to the debtor spouse upon dissolution.

H ran up a gambling debt of $50,000. This was without W's knowledge and not for the benefit of the community and therefore upon dissolution, a court would likely assign the remaining debt to H as that would be the equitable result and is within the court's discretion.

If a Creditor Makes a Claim post-separation and prior to property distribution

While separation terminates the marital economic community, it does not automatically terminate the CP estate. If a creditor makes a claim while the CP estate is still in existence, then the CP estate can be reached prior to the CP being distributed. In cases of contract debt, the creditor may opt to recover from the CP or the debtor spouse's SP.

In this case, even though W was not aware of the debt at the time of separation, the CP estate would still be liable. The casino could opt, at any time before property distribution, to seek recovery from CP or H's SP. However, any of W's SP would not be reachable to satisfy H's debt.

Answer B to Question 6

California is a community property state. All property acquired during marriage, other than separate property, is presumed to be community property. All property acquired before marriage or during marriage by gift or inheritance is presumed to be separate property. Further, all property acquired during marriage with the use of separate property funds is presumed to be separate property.

To determine the character of property upon divorce, the court will look to the source of the funds used to acquire the property. A mere change in form of the property will not change its character. Further the courts will also look to the actions of the parties which may have an effect on the character of the property and any presumptions that apply. Upon divorce, the court will divide all community property equally, unless the interest of justice require otherwise.

With these principles in mind, we can turn to the property in issue.

1) The Car?

No marriage- Separate property funds used to acquire

Here the car was acquired before marriage. In 2003 Wendy and Hank were engaged to be married. They discovered that the $10,000 monthly income Wendy derived from a trust fund would terminate upon her marriage or upon her reaching the age of 25, whichever came first. Therefore they decided to postpone their wedding until Wendy's 25th birthday, in 2006, and instead began living together. Also, Wendy in 2003 opened a checking account in both of their names, into which she deposited her $10,000 (which would be considered her separate property as there is no marriage) into an account in both of their names. Wendy also used the funds to buy a new car.

Thus at this point, their relationship would not be governed by community property law.

Hank will assert that he is entitled to a portion of the car because Wendy opened a checking account in both of their names, into which she deposited her $10,000 monthly trust income. Thus, Hank will assert that she made a gift of the trust property,

which before marriage, and even after marriage would have been considered separate property (as trust income is usually characterized as a gift or inheritance). However, Hank would have to satisfy the requirements of a contract under California's view on meritricious relationships.

Meritricous Relationship

California does not recognize common law marriage, but will recognize one that was contracted in another state that does recognize a common law marriage. Because there is no marriage at this point, any funds used would be separate property. Thus, as there is no community, any agreements the parties have as to any property would be governed by contract law, unless the main thrust of the contract is sexual relations. Here because instead of marrying one another and terminating the trust income payments, Hank and Wendy decided to move in together, there is no valid marriage and any agreements they have as to property would be governed by contract law.

Title to the car in both of their names

Accordingly, here Hank will assert that they had an agreement as to the car that it was to be in both of their names and thus he has a right to distribution of the car as partially his property. This would require that Hank prove that there was a contract between the two, as community property principles would not apply in this situation as, at this point there is no marriage.

Wendy will assert that she owns the car as her own separate property. She will assert that she used her funds prior to marriage, and thus the court should trace back the source of the property to her earnings prior to marriage. However, as noted above, if Hank is able to show that they had an agreement as to property acquired during the time pending their marriage and he is able to show that taking title in joint names evidences this agreement, he will be able to assert an interest in the car based on contract law. Further he will point to the fact that he quit his job in reliance upon their agreement to take title jointly to her trust income and thus there was valid consideration.

Further he will attempt to assert that the consideration for the contract was not sexual relations, rather it was the agreement that she would pursue an education, while

he would take care of the household chores. If Hank is successful, the car would be distributed pursuant to a contract between the parties, likely here equally as title was taken in both of their names.

Lucas- Anti Lucas

Alternatively Wendy will assert that Lucas decision and Anti Lucas apply here. Under Lucas, when a spouse expends separate property to take title jointly, a presumption arises that for the purposes of divorce, it is treated as community property. Under Lucas, all separate property expended for the acquisition of property in joint form would be presumed a gift. However California enacted Anti Lucas statutes to overturn this decision and entitle the separate property to be reimbursed in the form of an interest free loan. Thus she will assert that because title was taken in both of their names, the Anti Lucas statutes apply and she should be entitled to her down payment for the property in the form of interest free loan. However, because there is no community, this is not applicable here.

Wendy's use of trust income to pay living expenses for Hank and herself

It should be noted that Wendy's use of separate property, her trust income prior to marriage, for the living expense for Hank and herself will not entitle her to any reimbursement, unless they had an agreement to the contrary. It is presumed that when one party uses separate property for the expenses of another party, that it was intended as a gift. Thus, unless Wendy can show an agreement to the contrary, she will not be entitled to reimbursement for such expenditures.

2) The $30,000 in additional salary under the settlement?

Cause of actions that arise during marriage

A cause of action that arises during marriage is deemed to be a community property asset, subject to division upon divorce. Here in 2006, Wendy and Hank married. Thus the community commenced and all community property principles will attach to the relationship.

Wendy's $10,000 monthly trust income terminated. Afterwards, Wendy began teaching at a local college. In 2008, Wendy learned that her compensation was less than that of her male counterparts and made a claim against the college.

Consequently, because the cause of action arose during marriage, likely the court will find that any subsequent award is deemed community property.

Wendy will assert that because shortly after her separation, she settled her claim against the college in return for additional salary in the amount of $10,000 per year for the next three years, she will claim that this settlement was meant not as a settlement for past wages but as wage replacement for future years.

Wage replacement

Wendy will claim the settlement is meant as a form of wage replacement for the future years. Wage replacement under community property law are characterized upon receipt. Thus if received during marriage, will be deemed community property, however if received after marriage, will be deemed the working spouse's separate property. Here, Wendy will assert that as such, the $10,000 should be deemed her separate property. She will argue that wage replacements are characterized at the time they are received rather than at the time the cause of action arose. Thus she will assert that because she will receive the $10,000 after marriage, they should properly be deemed wage replacements characterized upon receipt.

Community property right to settlement

However, Hank will likely prevail in his assertion that the payments are for past services that occurred during marriage. All time labor and skill expended during a marriage is considered a valuable community property asset. Further all wages earned during marriage are considered community property. Here Hank will point to the fact that Wendy in 2008, learned that her compensation was less than that of her male counterparts and made a claim against the college. The following year, Wendy and the college settlement for an additional $10,000 per year for the next three years. Because this settlement was likely due because of the fact that during the marriage she was

earning less than her male counterparts, the intent of the college was to compensate her for her labor expended in the past.

Thus because Hank will successfully assert that the settlement was entered into to pay Wendy for past services, namely her years of employment at the college from 2006 to 2009, he will be entitled to a community property interest in the $30,000. Thus each will likely be awarded $15,000.

Education expenses

It should also be noted that if the community pays down the loans incurred to gain an education and that spouses earning capacity has been enhanced, the community will be entitled to reimbursement for such expenses made from community funds even if the education was gained prior to marriage, unless 1) the community has already substantially benefitted from the education, 2) the other spouse has gained a community funded education and 3) if it lessens the need for spousal support upon dissolution. Here there are no facts to indicate whether the education that Wendy received was at all funded by the community during marriage. However, in the case that the community did pay part of her education, she will assert the exceptions.

Community has already substantially benefitted

There is a presumption that arises if the education was gained 10 years before the end of a marriage, the community has already substantially benefitted and is not entitled to reimbursement. Here this is exception is inapplicable because Wendy earned the education in 2003, they married in 2006, and the community ended in 2008.

Other spouses Community funded education

There are no facts to indicate that Hank has received an education.

Lessen the need for spousal support

Wendy will likely assert that although she gained the education prior to marriage, it lessened her need for spousal support upon dissolution. She will assert that she was living off of a trust which expired in 2006, thus her education enabled her to gain

employment which lessened the need for spousal support. Thus she will claim that H is not entitled to reimbursement.

3) The $50,000 owed to the casino?

Debts during marriage

All parties during the marriage have equal right to manage and control the community. Thus each spouse is allowed to incur debt and borrow money. Such debt incurred during marriage is generally presumed to be community property. However, debt acquired during the marriage will likely be awarded to the debt incurring spouse. The non debt acquiring spouse's separate property will not be liable on the debt incurred by the other spouse. Here Unbeknownst to Wendy, Hank had run up a gambling debt to a casino during their marriage. At the time of their separation, Hank owed the casino $50,000.

Thus this debt during marriage would properly be characterized as community property debt. However, upon dissolution, the court will likely award the debt to the debt incurring spouse.

Necessaries

There is an exception to the general rule that one spouse's separate property will be unavailable to the other spouse's creditors. This exception applies for all debt incurred during marriage and even during the separation if the debt is incurred for a necessary. A necessary is one that is a requirement of life, such as medical care and food and water. Here because the debt was incurred by Hank for gambling at a casino, likely this exception would not apply. Debt incurred at a casino is not a necessary of life and as such Wendy's separate property will not be available to the casino.

Interest of justice require different allocation

The court may however, in the interest of justice require that different debt allocation be made upon divorce. The rationale is that at this point, the interest is in protecting the creditors. Thus the court may look to see which spouse is in a better position to repay the debt and may allocate the debt to such a spouse. Here the facts

indicate that Wendy was working for a college and actually earning a salary. However, Hank and Wendy agreed that Hank would quit his job and stay home taking care of the household chores. Thus if Hank is unable to repay the debt, it may be that the court will assign the debt to Wendy to assure that the Casino is repaid.

ESSAY QUESTIONS AND SELECTED ANSWERS
JULY 2012
CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the July 2012 California Bar Examination and two answers to each question that were written by actual applicants who passed the examination after one read.

The selected answers were assigned good grades and were transcribed for publication as submitted, except that minor corrections in spelling and punctuation were made for ease in reading. The answers are reproduced here with the consent of their authors.

Question 2

Wendy and Hal are married and live in California.

A year ago, Wendy told Hal that she would not tolerate his drinking any longer. She insisted that he move out of the family home and not return until he completed an alcohol treatment program. He moved out but did not obtain treatment.

Last month, Hal went on a drinking spree, started driving, and struck a pedestrian. When Wendy learned of the accident, she told Hal that she wanted a divorce.

Hal has consulted Lawyer about defending him in a civil action filed by the pedestrian. He is currently unemployed. His only asset is his interest in the family home, which he and Wendy purchased during their marriage. Lawyer offered to represent Hal if Hal were to give him a promissory note, secured by a lien on the family home, for his fees. Hal immediately accepted.

1. Is Wendy's interest in the family home subject to damages recovered for injuries to the pedestrian? Discuss. Answer according to California law.

2. Is Wendy's interest in the family home subject to payment of Hal's legal fees? Discuss. Answer according to California Law.

3. What, if any, ethical violations has Lawyer committed? Discuss. Answer according to California and ABA authorities.

ANSWER A TO QUESTION 2

1. **Is Wendy's Interest in the Family Home Subject to Damages Recovered for Injuries to the Pedestrian?**

California is a Community Property State

California is a community property (CP) jurisdiction. Thus, any property acquired by either spouse during the course of the marriage by either spouse's labor is presumptively community property. Property acquired before or after the marriage by either spouse, or during the marriage by gift, inheritance, or devise, is presumptively separate property (SP). In determining the character of a particular asset, it is helpful to look at (1) the source of the asset or the source of the funds used to purchase the asset, (2) any actions by the spouses changing the character of the property, and (3) any relevant presumptions.

The House

Source

The facts tell us that Wendy (W) and Hal (H) purchased the family house during their marriage. However, we don't know what funds were used to purchase the house. If W's or H's earnings were used (or a combination thereof), and those earnings were earned during the course of the marriage, then the house would be CP because spousal earnings are CP to the extent they're earned during the marriage.

However, if one spouse partially used inheritance money or other SP acquired before the marriage, then that spouse would likely have a SP interest in the home to the extent SP was used to purchase it.

However, without more, the best assumption is that spousal earnings were used to purchase the house. The facts say H is currently unemployed, but he may have been employed in the past (and thus had earnings). Further, we can assume W earned money somehow, likely from a job.

Actions

There is no evidence that the house was put in only one spouse's name, suggesting that the house was the separate property of that spouse. Pre-1975, if the house was in W's name, the married woman's special presumption would operate to render the house (or the share of the house in W's name) W's SP.

Modernly, if title was taken in only one spouse's name, a court would not likely hold that to be conclusive evidence that the house was that spouse's SP absent some manifestation by the other spouse that the house was intended as a gift.

If H and W took title to the house as joint tenants with a right of survivorship, each would have a 1/2 SP undivided interest in the whole during life. On death, the form of title would control. On divorce, under CA's anti-Lucas statute, the house would be treated as CP, with a right to reimbursement for any SP used by either spouse to improve the home.

Finally, there's no evidence of a transmutation changing the character of the house, which, after 1985, would have to be in writing.

Thus, absent any of these actions, it appears the house is still CP.

Presumption

All property acquired during the course of marriage is presumptively CP. Here, nothing rebuts that presumption.

Community Responsibility for Debts of One Spouse

All debts incurred by either spouse prior to or during the course of marriage are community debts. Tort obligations are "incurred" when the tort occurs, not when judgment is handed down. Thus, any obligations arising out of H striking the pedestrian were "incurred" when he hit the pedestrian.

W will argue that the marital economic community was not in existence when H hit the pedestrian because she had kicked him out of the house. The marital economic

community begins at marriage and terminates upon permanent physical separation when at least one spouse has no intent of continuing the marriage.

Here, W kicked H out of the house. However, she told him that he could return when he completed an alcohol abuse program. Thus, the marital economic community had not yet ended when H got in the accident because W was still open to the possibility of him returning. W will argue that H manifested an intent to never continue the marriage because he refused to go to treatment. In other words, W will argue that by rejecting the pre-condition to the continuation of the marriage--i.e. getting treatment--H effectively terminated the marital economic community. Indeed, W can point to the fact that 11 months after she kicked H out, he hadn't obtained treatment. Given this length of time, W can argue, it's clear that the community had ended.

However, the stronger argument is that the marital economic community continued until W told H that she wanted a divorce. If W viewed the marital community as over prior to the accident, she would have likely filed for divorce then. Instead, it appears the accident was the "last straw." Thus, the request for a divorce was the clearest signal by either party that the physical separation was permanent and there was no intent to continue the marriage.

Thus, the marital economic community had not ended when H struck the pedestrian, any obligation incurred because of the accident is a community debt.

Order of Payment

When a tort is committed during an activity for the benefit of the community, the debt will be satisfied first by CP, then by the tortfeasor's SP. The non-tortfeasor spouse's SP is not subject to the debt.

When a tort is not committed during an activity for the benefit of the community, the debt will be satisfied first by the tortfeasor's SP, then by CP. Again, the other spouse's SP is safe.

Here, H committed the tort against the pedestrian while driving drunk. This was not an activity for the benefit of the community--to the contrary, H was supposed to be seeking alcohol abuse treatment while he was living away from the family home. Thus, recovery would be taken out of H's SP before the CP.

However, on the facts, it doesn't seem as though H has any SP to satisfy the debt. Thus, any recovery will likely be against the H and W's CP.

Reimbursement to the Community

To the extent any CP--i.e. the house--is used to pay any obligation arising out of H's accident with the pedestrian, the community may be entitled to reimbursement from H. Where CP is used to pay an obligation arising out of spouse's tort that was committed not during an activity for the benefit of the community, the community is entitled to reimbursement for that payment if the tortfeasor's SP was available to pay (or if the order of payment was not followed). However, as mentioned, it doesn't appear H has any SP available to pay the debt and, thus, reimbursement may be unlikely.

Distribution of Debts on Divorce

At divorce, community assets are generally divided under the "equal division rule"--i.e. each spouse gets 1/2 of each community asset in kind.

However, a judge has more discretion as to the allocation of debts at divorce. Typically, a judge will allocate a tort debt to the tortfeasor spouse if the tort was incurred not during an activity for the benefit of the community. However, a judge may take into account ability to pay to effect a more just allocation of debts.

Here, on divorce, the judge would likely allocate any judgment based on H striking the pedestrian to H. H will argue that he's unemployed and can't pay, but it's highly unlikely a judge would saddle W with an obligation to pay H's tort liability post-divorce.

Conclusion

Thus, during the marriage, H and W's CP will be liable for damages recovered for injuries to the pedestrian. Even though H and W have filed for divorce, until community assets and debts are distributed, the community estate continues and the pedestrian can recover against it. However, as mentioned, on divorce, the debt will be allocated to H. Further, W may be entitled to reimbursement for CP used to pay the debt.

*Note: If the court decided that the marital community was terminated when H struck the pedestrian, then CP--i.e. the house--would not be liable for the debt because the debt would be H's SP.

2. **Is Wendy's Interest in the Family Home Subject to Payment of H's Legal Fees**

Equal Management

Each spouse generally has equal rights to manage community property. This includes the right to sell and encumber community property. However, with respect to real property, one spouse may not encumber community owned real property without the other spouse's consent. If one spouse, without consent, sells or encumbers community real estate, the non-consenting spouse has the power to void that transaction within 1 year.

Lien on the House

Here, H has given Lawyer a lien on the family home without W's consent. Thus, W has the power within 1 year to void the encumbrance.

H will argue that because he gave the lien on the house after W told him she wanted a divorce, he was only granting a lien on his 1/2 SP interest in the family home. However, there's no evidence that W actually filed for divorce or that divorce proceedings were held during which a judge divided the community estate. While the marital economic community may no longer exist because there has been permanent physical separation, the community estate lives on until it has been distributed.

Thus, a court would likely allow W to void the encumbrance on the community real property due to her lack of consent in making the encumbrance.

Timing of the Attorney's Fees

Furthermore, H sought legal advice after W told him she wanted a divorce. Because W asking for divorce terminated the marital economic community, CP--i.e. the family home--is not liable for the debts incurred by H after such separation.

Thus, any obligation owed to Lawyer based on legal services rendered to H cannot be satisfied out of CP because such an obligation would not be a community debt.

He would argue that payment of attorney's fees is an obligation arising out of the accident of the pedestrian, when the marital economic community still existed. However, the attorney's fees represent an entirely different event. Furthermore, contractual obligations arise when the contract was made. Here, any contract and/or agreement with Lawyer was made after the economic community ended. Therefore, W's interest in the family home is not subject to payment for the additional reason that CP is not liable for H's separate post-marriage debts.

Necessaries

Post-separation, a spouse can still be liable for obligations relating to necessaries that the other spouse incurred during the marriage. Necessaries generally refer to food, shelter, and medical expenses. Here, H's legal fees don't likely constitute necessaries and, as such, this theory cannot be invoked to hold W's interest in the family home subject to payment.

3. **Lawyer's Ethical Violations**

Obtaining Pecuniary Interest in Outcome of Case

Under the ABA, a lawyer cannot obtain a pecuniary interest in the subject matter of a case other than in the case of a contingency fee arrangement or an attorney's lien. However, in CA, attorneys' liens are impermissible.

Here, Lawyer effectively acquired an attorney's lien on H's family home. Thus, Lawyer will argue that this was permissible because the only purpose here was to secure payment. In CA, this would constitute an ethical violation. Under the ABA, it's less clear.

While under the ABA, an attorney's lien is permissible, if Lawyer knew that H couldn't rightfully encumber the family home, then it's possible that Lawyer committed an ethical violation because accepting the attorney's lien would constitute a violation of a third party's (W's) rights in the course of representing H.

Entering into Business Transactions with Clients

An attorney can only enter a business transaction with a client if (1) the terms are fair and reasonable, (2) the terms are communicated to the client in an easily understandable manner, (3) the client is advised to get independent counsel to represent him in the transaction and is given a chance to do so, and (4) the client consents.

Here, by taking a lien on H's family home, Lawyer entered into a business transaction with H. However, it's not clear that Lawyer ever advised H to seek independent counsel or that he adequately informed him of the material terms of the lien. Although H immediately accepted, he did so without knowing what would trigger enforcement of the lien (1 missed payment? total failure to pay? late payment? H's insolvency?). Thus, by failing to adequately inform H and encouraging him to seek independent advice, Lawyer likely violated the ethics rules.

Fees

Under the ABA, a fee must be reasonable. In CA, fees can't be unconscionable. Further, in CA, a fee agreement must be in writing unless it's (1) less than $1k, (2) with a corporation, or (3) for a routine matter involving an existing client.

Here, the lien agreement was essentially a fee agreement. However, the terms were not adequately disclosed to H. Further, there was no written fee agreement. Because a writing was likely required--there's no evidence H was an existing client or that Lawyer's services were valued at under $1k--this is a violation of CA rules.

Further, the lien was likely unreasonable and unconscionable. Because H was unemployed, it was extremely unlikely that he was going to be able to pay Lawyer's fees. If Lawyer knew that H was unemployed--which he likely did, considering he conditioned representing H on having a lien on the house--then Lawyer must have known that H wouldn't be able to pay. Thus, the fee agreement was unconscionable because it was akin to a mortgagee lending to a mortgagor knowing that the mortgagor was going to default and the foreclosure was inevitable. Lawyer must have known (a) that H wasn't going to be able to pay and (b) that the value of the lien on the home was worth more than the value of the services to be provided.

Thus, the fee arrangement likely constituted an ethical violation.

Violating Rights of Third Parties

Lawyers cannot violate the rights of third parties in the course of representing a client. To the extent the lien violates W's rights and Lawyer knew of this, he likely acted unethically. Furthermore, if Lawyer knew that H could not rightfully encumber the family house, then Lawyer arguably breached his duty of competent and candid representation by not informing H that he couldn't offer a lien on his house without W's consent.

ANSWER B TO QUESTION 2

1. **Is Wendy's interest in the family home subject to damages recovered for injuries to the pedestrian hit by Hal under California law?**

The parties were married and live in California. Thus, their property rights as a couple, specifically with regard to the property acquired during the marriage, are governed by California community property law. Whether the house was community or separate property can be determined by the source of the asset, whether any presumptions apply, and the actions of the parties during the marriage.

Community Presumption

There is a community presumption regarding property acquired during the marriage that it is community property. This would apply to the family home given, as the facts state, it was acquired during the marriage. The presumption can be rebutted by a showing that the house was not actually acquired during the marriage, it was acquired during the marriage but with separate property funds, the house was a gift/devise/inheritance, or the house was the rent/issue/profit derived from separate property.

Their house was purchased during the marriage so it was not a gift or devise. Although it is possible that the house was purchased with separate property funds, there are no facts to indicate this was the case. Because it was purchased during the marriage, and there are no facts to rebut the presumption, the house is considered community property.

Judgments Against Spouses

A tort judgment against a spouse will subject both the community property and the separate property of the tortfeasor to the judgment. But once the community property is divided, debt cannot be recovered from the spouse who received her half of the community property from what she received under the divorce decree unless she was the spouse that incurred the debt or the debt was assigned to her. Thus, for a judgment

against Hal for drinking and driving, the community will be liable for this debt, and it can be satisfied from the community property.

For the Benefit of the Community

Although the community property is liable for the judgment by the pedestrian, the judgment must be satisfied first from the separate property of the tortfeasor spouse if the tort was not committed by conduct that was being performed for the benefit of the community. For example, if Hal was on his way to drop the kids off at school or to pay the mortgage on the house, this would be for the benefit of the community. In that case, the judgment would be satisfied first from community property, and if there was any deficiency, then from the separate property of the tortfeasor.

Here, Hal had been kicked out [of] the house for his drinking problem at the time of the accident. Wendy had clearly communicated her disapproval for Hal's drinking. The drinking, including drinking and driving, would actually harm, not benefit, the community. Although we do not know where Hal was headed, he had already been kicked out of the house and was, generally, involved in a drinking binge at the time. Therefore, his actions were not to the benefit of the community and can be satisfied first from his separate property assets.

But the facts state that his only asset, at the present time, is his interest in the family home. Because it appears he has no separate property from which to satisfy the judgment, the judgment will be satisfied from the community property home.

End of the Economic Community

The accident in which the pedestrian was hit occurred after Hal had been kicked out of the house but before Wendy told Hal she wanted a divorce. As stated above, the source of property or debt, whether it was incurred before, during or after the marriage, can indicate whether it is community or separate debt. The pedestrian's claim is a form of debt because, once rendered, the plaintiff can reduce it to a judgment and attach liens to the tortfeasor's property. Thus, the question arises whether the economic

community ended when Wendy kicked Hal out of the house, because if so, the injury and judgment would have occurred after the economic community ended and would be the separate debt of Hal. In this case, the judgment could not be satisfied from community property, including the house.

In California, end of the economic community occurs when there is physical separation and an intent not to carry on the marital relationship anymore. If the parties maintain the facade or marriage, although physically separated, the economic community will not be considered to be at an end. The economic community will certainly result, if the above elements are not satisfied, when the divorce decree is entered.

Here, Wendy kicked Hal out of the house one year ago. She did not say anything about ending the marriage or never wanting to see him again. She did tell him he could not return until he completed alcohol treatment. Thus, Hal being kicked out was not indicative of an intent to permanently end the marriage relationship, it was indicative of a temporary physical separation by Wendy for the limited purpose of motivating Hal to get treatment and save the marriage. Thus the economic community would not have ended simply when he left the house.

But, after having moved out and hitting the pedestrian while drinking, Wendy learned of the accident and told Hal she wanted a divorce. At this point, both elements would be met. Hal and Wendy would have been physically separated, and one spouse has indicated an intention not to resume the marital relation by telling the other she wants a divorce.

Because the economic community did not end until that time, when Wendy told Hal she wanted a divorce, and the accident and/or the cause of action that is the basis for any judgment accrued before that time, the judgment resulting would be a community debt because it was essentially incurred before the end of the economic community.

Debt

Debt incurred before or during the marriage can be satisfied from the community or from the tortfeasor's separate property. Debt incurred by a spouse for necessaries, including medical care, can be satisfied from community property or the separate property of either spouse, although indemnity may be available. Here, the debt is for tort judgment and, as stated above, can be satisfied from either community property or separate property of Hal, first from his separate property and then from the community property.
In California, for the purpose of debt for necessaries or medical services, end of the economic community can only occur on divorce. Judgment may not be able to be satisfied from Wendy's earnings if she kept them in a separate (versus joint) account from which Hal had no right of withdrawal.

CONCLUSION--Because the debt was incurred before end of the economic community, it is a community debt. Therefore, it can be satisfied from community property or separate property of Hal. Because the tort that is the basis of the judgment was not conducted for the benefit of the community, the judgment must be satisfied first from Hal's separate property. But because Hal has no separate property, his only asset is the house, it will be reduced to judgment and recovery sought from the asset that is the community home, which as above is classified as community property. Wendy may be able to seek indemnity.

2. **Is Wendy's interest in the family home subject to payment of Hal's legal fees under California law?**

As stated above, the economic community ended when Wendy kicked Hal out of the house and told him she wanted a divorce. Hal appears from the facts to have consulted the lawyer after that time. Debt incurred after the end of the economic community will belong to the debtor spouse.

Attorney Fees for Divorce Lawyer

Generally, a spouse may not unilaterally encumber community real property without a joint action on behalf of both spouses. Additionally, the spouse may not separately

encumber her half interest in the property. The one exception to this rule is for the spouse to satisfy attorney fees in the divorce proceeding between the spouses.

Here, because the lawyer is not representing Hal as a family attorney in his anticipated divorce proceeding with Wendy, this rule would not apply. The lawyer fees incurred by Hal after the economic community ended for the purpose of defending against the tort suit could only be satisfied from Hal's separate property.

Division of Assets on Divorce

Generally, assets are divided pro rata at divorce, 50-50, no cashing out one spouse to give the other an entire asset. The only general exceptions to this rule are: for a closely held corporation whose shares are community assets where one spouse is the CEO and division would destroy the business; a pension plan from which one spouse can take a cashout instead of receiving payments from the pension so the spouse, who no longer wish to have any connection can go their separate ways; or, for the family home when selling it and dividing the proceeds will uproot the children and cause them harm.

While this is the family home, there appear to be no children and no reason not to apply the binding pro rata division, 50-50, by sale of the house and splitting the assets.

This means that on divorce, the assets of the house will be split evenly between the parties. Once the divorce decree is entered, the proceeds from the house that Hal receives are going to be his separate property. Upon divorce, the legal fees of Hal's lawyer can be paid by his share of the proceeds.

But the question asks whether the payment of Hal's legal fees will be satisfied from Wendy’s interest in the home. Wendy has no interest in Hal's proceeds after divorce from sale of the community property house, and thus the proceeds subject Hal's interest, not hers, to liability.

CONCLUSION--because the attorney fee debt will have been incurred after end of the economic community, it will be separate debt of Hal, and does not subject any of Wendy's interest in the family home to liability for those fees. The exception for divorce attorney fees does not apply.

3. **What ethical violations has the lawyer committed according to both the ABA and California law?**

A lawyer is a fiduciary of the client. She has a duty of confidentiality (not to communicate information relating to representation), a duty of loyalty not to act on behalf of her own, a client's, or a third party's best interests that are adverse to her client's, financial duties, and duties of competence which are all owed to the client.

Duty of Loyalty

Under the duty of loyalty, the lawyer must not develop an interest or maintain an interest that is adverse to the client, whether it is the interest of the lawyer herself, an interest of one of the lawyer's other clients, or an interest of a third party with whom the lawyer is closely related.

Loyalty--Financial Assistance to Clients

Under the ABA rules, a lawyer is not permitted to lend the client money for the representation, with the exception of forwarding costs of litigation to indigent clients and forwarding costs associated with a contingent fee arrangement. Under the California rules, the lawyer can lend the client any amount for any reason, as long as she does not promise to satisfy the existing debts of the client in order to buy the client's business.

Therefore, from this perspective, the loan would be considered acceptable under the California rules but unacceptable under the ABA rules. Under the ABA rules, once the client becomes indebted to the attorney, the attorney's personal interest against the client in collecting the money and receiving payment for the debt may conflict with his duty to act for the sole benefit of the client. Under the California rules, because this is not a promise to satisfy pre-existing debt for the prospective client, this is acceptable.

Loyalty--Transacting Business or Developing Adverse Interest to Client

Whenever the lawyer enters into business with the client, the terms must be fair, the lawyer must disclose the terms (effect of the transaction) to the client in writing, allow for an opportunity for the client to consult with independent counsel and probably should suggest she do so if the lawyer's interest will be adverse to the client's in the litigation, and obtain consent from the client in writing.

This loan would essentially be such a transaction. The facts do not indicate the above elements are met. Additionally, there is a question whether it would be fair to encumber a client's sole asset in order to receive payment. But the above rules that specifically address lending a client money are going to govern whether the transaction is permissible. Regardless, even though the loan is permissible under California law, the attorney should ethically consider whether the terms of the loan are fair and suggest receiving independent legal advice if the client wishes to fund the representation in this manner.

Financial Duties

The reason the nature of the fee arrangement is important is to judge whether it is permissible for the lawyer to charge the client in this way. Under the ABA, the fee must be reasonable considering the experience of the lawyer, novelty of the case, difficulty of legal issues, time and effort required, etc. In California, it simply must not be unconscionable. The question is whether the lawyer has complied with the requirements for charging a fee, and whether the amount is justified.

Contingent Fee

A lawyer can enter into either an hourly fee arrangement or a contingent fee arrangement with a client, or potentially a flat fee arrangement. Under the ABA rules, contingent fee arrangements (lawyer forwards fees and sometimes costs in order for a stake in the recovery, if there happens to be one) are not available in criminal or domestic cases. They must include the percentage of recovery taken, the costs deducted from recovery, and whether they are deducted before or after. In California,

the agreement must also indicate that it is subject to negotiation with the lawyer and what costs will not be covered by the contingent fee arrangement.

Under ABA rules, this may be a criminal case, but considering the question implies a money judgment that could subject the house to liability, brought by a private party pedestrian; using contingent fee arrangement in this case would be permissible. But here, if the mortgage is being used as payment, and thus this is more likely to be considered an hourly fee arrangement.

Hourly Fee

The agreement, under ABA rules, must disclose the rate at which the fee is charged, the services it covers, and the respective duties of lawyer and client. In California, it must also be in writing unless it is for less than $1,000, with a corporate client, routine matter for regular client, or emergency renders this impossible.

CONCLUSION--There is nothing in the facts to indicate the lawyer has complied with any of the above requirements regarding the fee arrangement. He made the offer to encumber the property without explaining the calculation of the rate, providing a writing, explaining what services it would cover, etc. Additionally, the case appears to be a simple one, involving culpability for drunk driving. Depending on how much the house was worth, a lien on the home could be unreasonable or unconscionable under either California or ABA approach.

Duty of Competence

A lawyer has a duty of competence, to represent the client with the skill, knowledge, thoroughness and preparation necessary to carry out the representation effectively.

As stated above, the home is community property. It cannot be encumbered unless both spouses jointly enter into the transaction. The non-consenting spouse can recover the house even from a BFP, and set aside the transaction, if she has not agreed to it.

There is a one year statute of limitations, but if the buyer knew the seller was married and failed to seek consent from the other spouse, there is no statute of limitations.

Here, an attempt to encumber the community property house to satisfy the separate debt of Hal would be a failure of competence on the part of the lawyer. A lawyer of reasonable skill, knowledge, thoroughness and preparation would be aware of this and would not attempt to encumber property to pay his debts knowing it was community property not subject to this type of transaction without consent of Wendy. This would ineffectively carry out the representation.

CONCLUSION--Under ABA rules only, the lawyer has breached his duty of loyalty to the client by lending him money in regard to the transaction. Although, he may argue he is permitted to do so because he is permitted to forward costs of litigation to indigent clients and Hal is indigent because he is unemployed and has no assets but the house. But because the house cannot be encumbered this way without the consent of Wendy, and a lawyer of reasonable skill and knowledge would know this, the attempt to encumber the house without Wendy's permission may also be a breach of duty of competence, subjecting the lawyer to discipline, sanctions, and malpractice liability. There is also a question of whether the amount of the fee is reasonable or unconscionable in light of the nature of the litigation and employment of the lawyer.

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ESSAY QUESTIONS AND SELECTED ANSWERS

JULY 2013

CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the July 2013 California Bar Examination and two selected answers for each question.

The answers were assigned high grades and were written by applicants who passed the examination after one read. The answers were produced as submitted by the applicant, except that minor corrections in spelling and punctuation were made for ease in reading. They are reproduced here with the consent of the authors.

Question Number	Subject
1.	Professional Responsibility
2.	Constitutional Law
3.	Community Property
4.	Contracts
5.	Wills/Trusts
6.	Remedies

Question 3

In 2007, while married to Hank and residing in California, Wendy inherited $150,000. Wendy used the money to purchase $50,000 worth of Chex Oil stock and a restaurant that cost $100,000. Hank managed the restaurant and, solely through his own efforts, it prospered and is now worth $300,000.

In 2008, Hank inherited an unimproved lot in California worth $75,000. Hank and Wendy obtained a construction loan from a bank for the purpose of building a rental house on the lot. In making the loan, the bank relied upon the salaries earned by both Hank and Wendy and, in addition, required that Wendy pledge the Chex Oil stock. A rental house was constructed on the lot. The present market value of the property, as improved, is $500,000.

In 2011, Cathy, a customer at the restaurant, tripped and fell over a box carelessly placed in the entryway by Hank. She obtained a judgment against Hank for injuries suffered in the fall.

Hank and Wendy have now decided to dissolve their marriage.

1. What are Wendy's and Hank's respective rights in:

    a. The Chex Oil stock? Discuss.

    b. The restaurant? Discuss.

    c. The rental property? Discuss.

2. To satisfy her judgment, may Cathy reach the community property, Hank's separate property, and/or Wendy's separate property? Discuss.

Answer according to California law.

SELECTED ANSWER A

Community Property

California is a community property (CP) state. All property acquired during marriage is community property. Separate property (SP) includes property owned before marriage, property acquired by gift, will, or inheritance during marriage, rents, issues, and profits from SP, and earnings after separation.

Characterization of property as either CP or SP depends on: (1) the source of the property; (2) any legal presumption affecting the property; and (3) any actions of the parties that may have changed the character of the property.

With these principles in mind, each item of property will be analyzed.

The Chex Oil Stock

Source

In 2007, while married to Hank (H), Wendy (W) inherited $150,000. Wendy used the $150,000 inheritance to purchase $50,000 of Chex Oil stock and a $100,000 restaurant. Thus, the source of the Chex Oil stock was W's inheritance, which is W's SP.

Presumptions

All property acquired during marriage is presumed CP. This presumption can be rebutted by tracing to a SP source or by an agreement to the writing to the contrary. Here, W can trace the $50,000 used for acquisition of the Chex stock to her $150,000 inheritance. W's inheritance is her SP. Thus, the general CP presumption is rebutted by tracing the funds used to purchase the stock to a SP source, the inheritance.

Actions

The only action taken by the parties with respect to the Chex stock was to pledge it as collateral for the loan to build the rental property.

Parties may transmute property from SP to CP and vice versa, which is a change in character of the property. After 1/1/1985, any transmutation must be in writing, clearly state the change in character of the property, and be signed by the spouse whose interest is adversely affected.

Here, there was no agreement between H and W that the Chex stock be transmuted from W's SP to CP. The fact that the bank required H and W to pledge the Chex stock as collateral for the bank loan to build the rental property is not sufficient evidence of a transmutation because it does not state any intent that W is transmuting her SP to CP.

Thus, the pledging of the Chex stock as collateral does not change the character of the stock.

Disposition

Because the stock can be traced to a SP source, the general CP presumption is rebutted, and has had no change in character; the Chex stock is W's SP. Now that H and W are seeking dissolution of their marriage, the Chex stock will be awarded solely to W as her SP.

The Restaurant

Source

In 2007, while married to H, W inherited $150,000. Wendy used the $150,000 inheritance to purchase $50,000 of Chex Oil stock and a $100,000 restaurant. Thus, the source of the restaurant was W's inheritance, which is W's SP.

Presumptions

All property acquired during marriage is presumed CP. This presumption can be rebutted by tracing to a SP source or by an agreement in writing to the contrary.

Here, W can trace the $100,000 used for acquisition of the restaurant to her $150,000 inheritance. W's inheritance is her SP. Thus, the general CP presumption is rebutted by tracing the funds used to purchase the restaurant to a SP source, the inheritance.

Actions

Hank managed the restaurant during the marriage.

CP Contribution to SP Business

A spouse's effort, skill, and industry during marriage is a CP asset. Where a spouse contributed his or her effort, skill, and industry during marriage to his or the other spouse's SP asset, and the asset increases in value, the community receives an interest in the asset. There are two different accounting methods to determine the value of the respective SP and CP interests in the business at dissolution.

Here, H contributed his effort, skill, and industry, which is a CP asset, to the restaurant, which is W's SP asset, during marriage.

The court is not required to use either formula and may choose, or may use whichever formal the parties provide evidence in support of.

Pereira

The Pereira formula is used where the major factor contributing to the increase in value is the spouse's personal effort. Under Pereira, the value of the SP portion of the asset is equal to the value of the SP asset at the time of marriage or the time of acquisition during marriage, plus a reasonable rate of return, usually 10% per annum. The residual value belongs to the community.

Here, managing a restaurant takes personal effort and industry. The facts state that "solely through [H's] own efforts, it prospered." Thus, it appears that Pereira would be the more appropriate formula to use in this circumstance.

Here, the restaurant was purchased in 2007 for $100,000. Now, in 2013, H and W seek dissolution of marriage. Assuming that the purchase price was the fair market value of the restaurant at the time, the SP portion of the restaurant will be equal to $100,000 plus $10,000 per year for six years, or $160,000. The residual value, of $140,000 ($300,000 - $$160,000) is the community's interest in the restaurant.

Thus, under the Pereira formula, the restaurant will be $160,000 CP and $140,000 SP.

Van Camp

The Van Camp formula is typically used where the SP business is valuable and increases in value due to the existence of the business and market forces, and not the personal effort or industry of the spouse. Under Van Camp, the community receives a reasonable salary in return for the spouse's contribution of time and effort, reduced by the amount of community expenses paid by the returns from the business. The residual is the owning spouse's SP.

Here, as explained above, the restaurant in value because of H's contribution of effort and industry, not because of market forces. Thus, the Van Camp formula is probably not the more appropriate formula.

Under Van camp, the community would be credited with a reasonable salary for the 6 years that H spent managing the restaurant, less any community expenses paid by the returns from the restaurant. The balance will be W's SP.

Disposition

Since Pereira is probably the better formula, the restaurant will be $160,000 CP and $140,000 SP.

The Rental Property

Source

In 2008, H inherited an unimproved lot worth $75,000. Inheritance during marriage is the inheriting spouse's SP. Thus, the source of the lot is H's SP.

Regarding the construction loan, the personal credit of either spouse during marriage is a community asset. Here, a loan was obtained from the bank for the construction of the rental property. The loan was obtained in both spouses' names and the bank relied upon the salaries earned by both H and W. The bank also required W's Chex stock as collateral.

Since the bank relied on the personal credit of both spouses, the bank loan is CP.

Presumptions

All property acquired during marriage is presumed CP. The presumption can be rebutted by tracing to a SP source or a written agreement to the contrary. Here, the lot was acquired in 2008, during the marriage. However, the lot can be traced to H's inheritance, which is SP. The bank loan is presumed CP because it was acquired during marriage. There are no facts that can rebut this presumption. W may argue that her pledge of collateral of the Chex stock makes the bank loan her SP, but this argument will be rejected because the bank specifically relied on the salaries earned by both H and W.

Actions

Improvement of Separate Real Property with CP

Here, the bank loan (CP) was used to improve an SP asset (H's lot).

Where CP is used to improve a SP asset, the community is entitled to an interest. The formula used for calculating such an interest is from In re Marriage of Moore. The community is entitled to reimbursement for the value of the contributions for down payment, improvements, and payment of principal, plus a pro rata share of the appreciation.

Here, the community will receive reimbursement of the principal payments made on the bank loan, plus a pro rata share of the appreciation calculated by dividing the CP contribution by the total contribution of SP and CP. The facts do not give enough details to make such a calculation, but it will be some portion of the $500,000 present market value.

Disposition

The rental property is part CP and part SP as discussed above. The CP portion will be divided equally upon dissolution.

What Can Cathy Reach to Satisfy Her Judgment?

Liability of CP and SP for Tort Judgment

CP is liable for all debts incurred by either spouse before or during marriage. Where a judgment results from a tort committed by one spouse, the order of satisfaction of the judgment depends on whether the tortfeasor spouse was acting for the benefit of the community at the time the act giving rise to the judgment was committed. If the tortfeasor spouse was acting for the benefit of the community, the judgment may be satisfied first by CP and then by the tortfeasor spouse's SP. The non-tortfeasor spouse's SP is not liable. If the tortfeasor spouse was not acting for the benefit of the community, the judgment may be satisfied first from the tortfeasor spouse's SP and then from CP. The non-tortfeasor spouse's SP is not liable.

Here, H placed a box in the entryway of the restaurant, presumably while working at the restaurant. Cathy, the customer, obtained a judgment against Hank. If Hank was working at the restaurant and placed the box in the entryway negligently, in the course of his work, he was acting for the benefit of the community because the community had an interest in the restaurant and H's wages from the restaurant were CP. Alternatively, if H placed the box there and injured Cathy intentionally, or did not place the box there as part of his work at the restaurant, he was not acting for the community. Here, it is probably more likely he was acting for the benefit of the community.

As such, Cathy must first satisfy her judgment from CP, which includes a portion of the restaurant and a portion of the rental property. Once CP is exhausted, and if it is, Cathy must satisfy the balance of her judgment from H's SP, which includes a portion of the rental property. Cathy cannot reach the portion of the restaurant that is W's SP and cannot reach the Chex Oil stock, which is also W's SP.

SELECTED ANSWER B

California is a community property state. In California, there is a community presumption. Under the community presumption, property obtained during marriage by the spouses is presumed community property. There are also areas of separate property. Property obtained by either spouse before or after the marriage is typically separate property. Additionally, any property obtained by gift, will, or inheritance by either spouse is that spouse's separate property. Property that is obtained using separate property also remains separate property. With these considerations, Hank and Wendy's respective rights will now be considered.

1. Hank and Wendy's Rights in Property

Chex Oil Stock

While married to Hank and residing in CA, Wendy inherited $150,000. As described above, an inheritance by a spouse is separate property of that spouse despite the community presumption. Wendy used $50,000 of this money to buy the Chex Oil stock. The use of separate property to obtain other property results in that other property remaining separate property. Therefore, the Chex Oil stock was separate property when it was bought by Wendy.

Hank may argue that Wendy intended to make the stock a gift to the community when she used it as part of the collateral for the loan obtained by the couple in 2008. Since 1985, however, a transmutation of property from separate property to community property must be in writing and show the intent of the separate property holder to effectuate a gift to the community. Because Hank would not be able to produce such a writing, he will not be able to show that Wendy made a gift to the community.

The Chex Oil stock is Wendy's separate property.

Restaurant

While married to Hank and residing in CA, Wendy inherited $150,000. As described above, an inheritance by a spouse is separate property of that spouse despite the community presumption. Wendy used $100,000 of this money to buy the restaurant.

As described above, the use of separate property to purchase other property results in that property remaining separate property. Therefore, the restaurant was separate property when it was bought by Wendy.

The restaurant has increased in value because of Hank's efforts. Hank's labor is considered community property. The use of community property to enhance the value of a spouse's separate property is analyzed by the court in different ways.

When the separate property is the separate property of one spouse and then other spouse uses community property to enhance the value of the first spouse's separate property, courts in CA may sometimes consider this a gift by the second spouse to the first spouse. Here, hank used community property assets (his labor) to increase the value of the separate property owned by Wendy (her restaurant). Some courts may interpret this as a gift by Hank to Wendy.

The gift interpretation, however, is more likely to be used when a monetary or similar transfer of community property is made to enhance the separate property's value. Here, Hank worked for at least 4 years (depending on when they seek dissolution of the marriage – it could be 6 years) at the restaurant. It is unlikely he intended these years of work to be a gift to Wendy's separate property. Some courts will refute the presumption that the community property going to the other spouse's separate property was a gift and instead hold that the portion is community property.

In determining what portion is community property, courts will apply analysis either from the *Pereira* case or the *Van Camp* case.

The *Pereira* formula is often applied when the labor of the spouse has resulted in the increase in the value of the business. This is the case here, where the facts state that the restaurant has prospered "solely through his own efforts" as manager of the restaurant. The *Pereira* formula considers the value of the property at the time it was acquired (or time of the marriage if that comes after), and gives the spouse owning the separate property a fair return on the investment, which would be 10% per annum. Based on this analysis, and assuming 6 years have passed, Wendy would get 10% of the restaurant's initial value, or $10,000, each year. This would result in $60,000 of

increase. So $160,000 of the property remains Wendy's separate property and the other $140,000 is community property.

The fact that Hank was working instead of Wendy does not change this analysis. Typically the owning spouse may work on her own separate property. Regardless, community property (Hank's labor) was put towards the business to make it grow, and so the *Pereira* formula would view the fair investment return to be community property.

The *Van Camp* formula applies when the property increases in value because of its inherent worth. This does not apply here because the property increased due to Hank's efforts, not the restaurant existing itself. This formula would look at the reasonable rate of compensation for the spouse and deduct the expenses of the couple. The remaining value of the salary would be community property, and the remaining value of the business would be separate property of the spouse. As mentioned above, it does not apply here because the restaurant increased in value due to Hank's efforts and because it was Hank working on the property rather than Wendy.

Their respective rights in the property should be $160,000 separate property of Wendy and $140,000 community property, which the couple would split upon divorce.

Rental Property

While married to Wendy and residing in CA, Hank inherited an unimproved lot worth $75,000. As described above, an inheritance by a spouse is separate property of that spouse despite the community presumption. The unimproved lot, therefore, was separate property of Hank.

The community then obtained a loan to improve the property into a rental property. Whether a loan is considered community property or separate property depends on what the creditor looked at for satisfaction of the loan.

Here, the creditor looked at the salaries of each and the value of the Chex Oil stock. Because of the inclusion of the Chex Oil stock, Wendy may argue that the loan should be considered her separate property that then went into the rental property. The value of the stock, however, was only $50,000. In order to go from an unimproved lot to a rental property worth $500,000, the creditor likely made a substantial loan and relied

primarily on the salaries of each spouse. The salaries of each spouse at that time, and therefore their creditworthiness, is a community asset. The loan, therefore, should be considered a community asset.

As above, this involves the use of community property to enhance the value of separate property of a spouse. Hank may argue that Wendy intended her use of community property to enhance the value of his separate property to be a gift. Courts have analyzed this in different ways, as described above. Here, it is unlikely that a court would determine this to be a gift and instead hold that the community has some interest in the property.

Wendy may argue that Hank intended a gift to the community by using the community loan to build up his property. As explained above, however, a transmutation requires a clear writing by the party giving the gift. Here, there is no writing showing that Hank intended a gift. The court would determine that Hank did not gift the entire property to the community.

Instead, the court must then determine what percentage of the property is community property. The land went from unimproved and worth $75,000 to improved and worth $500,000.

Wendy may argue that the increase should all be considered community property, potentially subject to a reasonable increase in the original investment. This would essentially be like an argument that *Pereira* should apply because it is now a business and community assets went into it to increase its value. If this were used, the property would receive a fair 10% increase per annum and the community would receive the remaining value of the property.

Alternatively, the court looks at the amount of the loan that was received. The court could then compare this amount to the original value of the land to do a proration analysis. Under this theory, the court would look at the original $75,000 value of the land and compare it to the value of the loan (I'll assume $125,000 for basic calculation and demonstration purposes). If the loan were $125,000, then the total value going into the property would be $200,000 (75,000 + 125,000). The court would then prorate the proportion of separate property and community property to the value of the property

today, which is $500,000. The proportions of the separate property (3/8 in assumption) and the community property (5/8 in assumption) would be prorated to the $500,000 value to determine amounts of separate property and community property.

The court may also alternatively look at the amount of the loan and view this as the community property and merely require a reimbursement for the amount of money that went into the undeveloped land.

Because of the increase in the property value due to the improvements, some form of proration would likely be better for the court to apply to afford a more fair split of the property value.

2. Cathy's Judgment

Cathy, a patron at the restaurant, has received a judgment against Hank for his negligence. Based on the facts, it appears that the judgment is only against Hank individually and not against the restaurant itself. The analysis below will assume that Hank is individually liable and the restaurant is not vicariously liable for the judgment.

Because Hank is personally liable for the judgment, his separate property is subject to Cathy's judgment. Cathy may therefore go after Hank's portion of the rental property that is his separate property. She may also go after any other separate property owned by Hank.

The tort liability of one spouse can affect the community assets. Cathy would be allowed to go after the community assets to satisfy her judgment. The order in which she obtains her judgment, however, depends on whether the spouse was acting for the benefit of the community at that time or for his own separate benefit. Here, Hank was working at the restaurant for the benefit of the community when the tort liability was incurred. Because Hank was acting for the betterment of the community, Cathy may go after the community property before she is forced to go after Hank's separate property for the judgment. To the extent that Wendy's community property interest is infringed by Cathy's judgment, she may be able to seek reimbursement from Hank at the divorce because she is not personally liable for the tort.

Wendy's separate property is not subject to the tort liability of Hank. Wendy is not individually liable for the tort (again, assuming that the restaurant is not vicariously liable). Additionally, community property of Wendy, such as wages, kept in a separate account that the other spouse cannot access could not be reached by a creditor unless for the necessaries of the other spouse. Here, Hank is liable for a tort, not a contract for necessities, so the necessaries exception would not apply. Additionally, Cathy's Chex Oil stock that she keeps separate is separate property rather than community property that she keeps separate, so it could not be reached by Cathy.

Therefore, Cathy may go after Hank's separate property and the community property to satisfy her judgment. She may not go after Wendy's separate property.

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ESSAY QUESTIONS AND SELECTED ANSWERS

FEBRUARY 2014

CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the February 2014 California Bar Examination and two selected answers for each question.

The answers were assigned high grades and were written by applicants who passed the examination after one read. The answers were produced as submitted by the applicant, except that minor corrections in spelling and punctuation were made for ease in reading. They are reproduced here with the consent of the authors.

Question Number	Subject
1.	Professional Responsibility
2.	Community Property
3.	Civil Procedure
4.	Real Property
5.	Constitutional Law
6.	Remedies

Question 2

Hank and Wendy are residents of California. Hank is a teacher and Wendy is an accountant.

In 2008, Hank and Wendy married. After their wedding, Wendy's mother deeded them a house as joint tenants. They moved into the house and used their earnings to furnish it in a lavish style, including an antique mirror in the entryway. One day, Hank gave the mirror to a friend who had admired it on a visit to the house.

In 2012, Wendy purchased a small office building where she established her own accounting practice. She paid for the building with funds saved from her earnings during her marriage and took title in her name alone.

In 2013, Hank and Wendy separated. Hank told Wendy that the house was henceforth her separate property and she said, "O.K."

After the separation, Wendy's income from the accounting practice tripled and she remodeled the office building with her increased earnings. Without Hank's knowledge, she then sold the building to Bob, who did not know that she was married.

In 2014, Wendy initiated dissolution proceedings.

1. What are Wendy's rights, if any, as to the antique mirror? Discuss.

2. What are Hank's and Wendy's rights, if any, as to the following:

    a) The house? Discuss.

    b) The accounting practice? Discuss.

    c) The office building? Discuss.

Answer according to California law.

QUESTION 2: SELECTED ANSWER A

Community Property Generally

Since Hank and Wendy are residents of California, the law of California will be applied in their divorce proceeding. California is a community property (CP) state. The general presumption is that all property acquired by either spouse during the marriage, real or personal, is CP. On the other hand, all property that is acquired by gift, bequest, devise or descent is considered separate property (SP) of the spouse who received it. In this case, the ownership of each of the assets will depend on whether the CP presumption controls, or the actions of the parties or some other presumptions have changed the character of the property. Each asset will be discussed separately below.

The Mirror

The first issue is whether Wendy has any rights in the antique mirror that Hank gave away to his friend. In this case the mirror was acquired during the marriage, and was purchased using the earnings of both parties; therefore the mirror is considered CP. There are no facts to indicate that the parties changed the character of the mirror and therefore the CP presumption is controlling.

Gift To the Friend

The issue here is whether Hank has fully disposed of the mirror by giving it away to his friend. After 1-1-1975, both spouses to the marriage acquired the rights to equal management and control of the marital assets. Under the rules regarding the rights of equal management and control, one spouse may not make a gift of CP without the consent of the other spouse.

Here, Hank gave the friend the mirror, and there is no indication that he asked for Wendy's permission before doing so. Hank may argue that although spouses may not

make gifts of CP without the other spouse's permission, the general rule is that the parties can dispose of personal property. On the other hand, the general rule is that spouses may not dispose of personal property without the consent of the other spouse, for less than fair market value. Here, the facts indicate that the parties decorated their house in a "lavish style" and that the mirror was an antique; therefore it is reasonable to assume that this antique mirror was fairly valuable. Since Hank merely gave the mirror to a friend, and received no consideration for the gift, he has breached his spousal fiduciary duty owed to Wendy. The gift to the friend was improper.

When one spouse makes an improper gift, the other spouse has a right to set aside the gift. In this case, if Wendy were trying to contest the gift during the marriage, she could set aside the entire gift. However, at divorce, a spouse only has a right to set aside one-half of the gift, because the parties each have a one-half interest in all CP. In this case, Wendy would be able to set aside one-half of the gift at divorce. Since the gift was of personal property and a mirror cannot be physically divided, the court will probably value the mirror and award Wendy one-half of its value through another source of money during the dissolution.

The House

Next, the court must determine how to characterize the house that was given to Wendy and Hank sometime after 2008. Since the parties were married in 2008 and the house was acquired afterwards, it is presumed to be CP. However, in this case, the house was received as a gift. The facts indicate that Wendy's mother deeded it to them as joint tenants. As discussed above, gifts during the marriage are considered to be SP of the spouse receiving the gift. In addition, when parties own property in Joint Tenancy, during the marriage it is classified as two SP halves. Therefore, during the marriage, this house would be considered two SP halves owned by each spouse.

Actions By the Parties

The issue here is whether the discussion between Hank and Wendy in 2013 changed the character of the house. Here, the facts indicate that Hank told Wendy that the house was "henceforth her SP" and that Wendy said "ok." This is an attempt at a transmutation. A transmutation is an action by the spouses to change the character of the property that the spouses already own.

Prior to 1985, transmutations could be of the most informal character, including orally. Here, there was an oral agreement to transfer the house to Wendy's SP at the couple's separation in 2013. If this was prior to 1985, this would be valid. However, modernly a transmutation is not valid unless it is in writing, indicates that there is a change in the character of the property, and is signed by the adversely affected party. In this case, Hank would be the adversely affected party because he would be abandoning his one-half interest in the property and giving it to Wendy. However, since there was no signed writing, this oral promise to change the character of the property to Wendy's SP is unenforceable.

Anti-Lucas Legislation

Since the transmutation was ineffective, the court must now determine how to divide the property at dissolution. Here, the property is held in joint tenancy, which is inconsistent with the basic CP presumption that all property acquired during the marriage is CP. However, under the Anti-Lucas Legislation, for purposes of dissolution only, all property held jointly is treated as CP. This presumption can only be overcome by a statement in the deed that the parties intend to hold title differently or a written companion agreement. In this case, the mother merely deeded the property to the spouses as a gift. It is unlikely that they literally intended for the property to be owned one-half by each of them as their SP. In addition, there is no written agreement indicating otherwise. Therefore, the house will be treated as CP. Since the house is treated as CP at dissolution, both Hank and Wendy have a one-half interest in the property.

The general rule is that at divorce, CP should be divided equally in kind. However, the court can fashion other relief if necessary. In this case, since Hank evidenced an intent to give the house to Wendy, the court may allow Wendy to keep the house, and just award Hank the value of one-half of the house.

The Accounting Practice

Next, the court will address the accounting practice of Wendy's. Although Wendy was an accountant prior to the marriage, the facts indicate that she established her own practice in 2012 during the marriage. Since the work of a spouse is considered CP labor, the earnings a spouse earns from work are CP funds.

Calculating the Value Of the Business

When there is a spouse that has a SP business, the court must determine how to allocate the business and the earnings from the business. The court does this by applying one of two formulas, each of which will be discussed below.

Pereira

Under the Pereira formula, the court takes the initial investment of the spouse, multiplies it by a simple and arbitrary interest rate (typically 10%) and then multiplies that by the number of years the spouse worked in the business during the marriage. That figure is considered to be a rate of return on the initial investment, and is awarded to the spouse who started the business with her SP, the remaining amount is considered CP.

Van Camp

Under the Van Camp formula, the court will calculate a reasonable rate of earnings for the working spouse, and multiply that by the number of years the spouse worked during the marriage. This figure would then be awarded to the community as CP. The

remaining funds would be considered SP of the spouse, and attributable to standard increases in value to the business due to the market.

In general, the court will use the Pereira formula when the increased value of the business was attributable to the work of the spouse in the business. In contrast, the courts will use Van Camp when the increase in value of the business is due to the overall market economy.

In this case, however, it does not appear that the court would use either approach. The facts indicate that the business was opened during the marriage, using money that Wendy had earned during the marriage. Because the money was earned during the marriage, the business itself is considered CP and not Wendy's SP. Therefore, the accounting business as of 2013 should be considered CP and should be divided equally between the parties at dissolution.

Post-Separation Earnings

In this case, the facts indicate that the earnings of the accounting practice tripled after the separation. The general rule is that marital community ends when there is physical separation of the parties with no intent to rekindle the relationship. Here, the facts indicate that the parties separated in 2013. It is unclear whether there was physical separation, but since Hank told Wendy that the house was her SP, it is likely that he moved out of the house at that time. If the court finds that 2013 was the date the marital community ended, then no CP could be established after that time, and all of the increased earnings in the accounting practice would be Wendy's SP. If the court finds that there was no true separation until 2014 when Wendy filed for divorce, then the accounting practice value as of 2014 would be divided equally between the parties as CP earned during the marriage. But, under these facts, it is most likely that the court will find that 2013 was the date that the marital community ended, and award the increased profits to Wendy as her SP.

The Office Building

Last, the court must determine the character of the office building in order to determine if Hank has any interest in it, notwithstanding the fact that Wendy sold it to Bob.

The property was acquired during the marriage using funds from Wendy's earnings; therefore the office building is initially characterized as CP.

Actions Of the Parties

The issue here is whether the general CP presumption can be rebutted since Wendy took title to the property in her name alone. Under California law, there is a form of the title presumption, which holds that the holder of record title to a property is presumed to be the true owner. In this case, Wendy will argue that the property is hers because she took title in her name alone, and therefore the form of the title prevails.

However, in order for the form of the title presumption to apply, the title must itself have evidentiary value. In this case, the title may not prevail, because there are no facts to indicate that Hank agreed to her taking title in her name alone. Wendy may argue that since the office was purchased with CP earnings, the community made a gift to her and she could take the property as her SP. However, there are no facts to support this. There is no evidence to show that Hank knew that she took title in her name alone, let alone that he agreed for her to do so. Therefore, the title will not be controlling. Since the property was acquired with CP funds, the property will be considered CP.

Post 2013 Actions

Although the property will be classified as CP, the court must determine how to handle the fact that Wendy remodeled the business with her increased earnings after the date of separation. As discussed above, all property that is acquired after the date of

separation is considered to be SP of the acquiring spouse. In this case, Wendy's earnings from her accounting practice post 2013 are characterized as her SP.

SP Improvements To CP

Since the money used in the remodel was Wendy's SP, the court will treat this as a SP improvement to a CP asset. Historically, if a spouse contributed SP to a CP asset, it was considered a gift. However, modernly the general rule is that if a spouse contributes SP to a CP asset, he can be reimbursed for SP down payments, loan reductions, and improvements. Here, Wendy remodeled the office building and therefore this will be characterized as an improvement. Wendy will then be entitled to reimbursement to her SP for either the cost of the improvement, or the increased value to the building because of the improvement.

The Sale to Bob

In this case, the classification of the office building is slightly complicated by the fact that Wendy sold the property to Bob. The general rule is that when disposing of CP real property, both spouses must participate in the sale and sign the appropriate documents. However, in this case, the facts indicate that Wendy sold the house without Hank's knowledge, which means he clearly did not participate in the sale. Here, it was easier for Wendy to do this, because the house was titled in her name alone and therefore Bob was unaware that she was married.

When a spouse disposes of real property without the consent of the other spouse, the injured spouse can set aside the sale if it is done within one-year of the sale. In this case, the facts are not clear when exactly the sale took place, but it was sometime between 2013 when they separated and 2014 when Wendy initiated divorce proceedings; therefore one year has not passed. Hank may be able to set aside the sale once the court makes the determination that the office building was in fact CP. On the other hand, since Bob did not know that Wendy was married and he bought the

building for consideration, he is considered a bona fide purchaser. The court may not want to injure Bob by voiding the sale, so the court may instead award Hank the value of one-half of the building.

Spouse's Obligations to Each Other

As discussed above, spouses have equal management and control of the CP assets. In addition, spouses are in a reciprocal fiduciary relationship with each other, and therefore owe each other a duty to act fairly and honestly with each other. If the court finds that Wendy acted fraudulently when she took title in her name alone and when she sold the property to Bob without Hank's knowledge, then the court could penalize her for this fraudulent behavior for breaching her fiduciary duty to Hank. Since the fiduciary duty continues until the assets have been fully divided in dissolution proceedings, Wendy still owed Hank this duty as of the date that she sold the property. However, absent a showing of fraud, the court will divide all of the assets as discussed in detail above.

QUESTION 2: SELECTED ANSWER B

California is a community property state and all property acquired during a marriage and before permanent separation is presumed to be community property ("CP"). Any property acquired by either spouse before marriage or after permanent separation is presumed to be separate property ("SP"), as is any property acquired by either spouse by gift, devise or bequest. At divorce, a court generally will award each spouse one-half of the CP in kind.

1. What are Wendy's rights, if any, as to the antique mirror?

The issue to be considered in determining Wendy's rights, if any, in the antique mirror, is whether the antique mirror is CP and whether Hank had a right to give the mirror to his friend.

The mirror is CP. Any property acquired during Hank and Wendy's marriage with CP is presumed CP. Earnings of either spouse are considered CP. Because the mirror was purchased with Hank and Wendy's earnings, it will be CP.

Under California law, both spouses have equal rights to manage and control CP. Thus, one spouse may not dispose of a piece of CP without the permission of the other spouse. Because Hank did not seek Wendy's permission in making a gift of the mirror, the gift is invalid and Wendy may try to rescind the gift and reclaim the mirror as CP. In the alternative, if the mirror is not recoverable, Hank may be required by the court to reimburse the community for the value of the mirror. Thus, in any event, unless Wendy consented to the gift, Wendy will retain her one-half interest in the antique mirror.

2. What are Hank's and Wendy's rights, if any, as to the following:

a) The house?

To determine Hank's and Wendy's rights, if any, in the house, we must determine whether the house is CP and whether any subsequent action altered that characterization.

The house was deeded to Hank and Wendy after their marriage as joint tenants. Under California law, any property held by husband and wife as joint tenants is presumed to be CP as holding in joint tenancy is antithetical to SP status; however, if the property is purchased or improved with SP, the SP is entitled to reimbursement from the community on divorce. (In contrast, on death, Lucas holds that any contribution by SP to property held in joint tenancy is a gift and there is no right to reimbursement.) The fact that Wendy's mother deeded the house to Hank and Wendy will not overcome the presumption that property held in joint tenancy will be considered to be CP. Although property given as a gift to one spouse (as one might have assumed Wendy's mother would have done) will be presumed to be SP, here Wendy's mother explicitly deeded them the house as joint tenants. Hence, it will be presumed to be CP as discussed above. Thus, prior to separation, each of Hank and Wendy had a one-half in kind interest in the house.

After the separation (which I presume for purposes of this question is a permanent separation as there are no facts to the contrary indicated in the question), Hank told Wendy that the house was henceforth her separate property and she said "O.K." In order to effectively transmute property that is CP to SP, and vice versa, under California law a valid transmutation agreement is required. Prior to 1985, an oral agreement could be effective to transmute property. However, after 1985, a transmutation must be in writing to be valid. As the purported agreement to cause the house to be SP occurred in 2013, it will be invalid. Thus, the house will remain CP and each of Hank and Wendy have a one-half in kind interest in it.

b) The accounting practice?

To determine Hank's and Wendy's rights, if any, in the accounting practice, we must determine whether the accounting practice is CP and whether any subsequent action altered that characterization.

Wendy established her accounting practice during the marriage with her labor. Any property acquired during Hank and Wendy's marriage with CP is presumed CP. Labor and earnings of either spouse are considered CP, and any goodwill created during the marriage and before permanent separation is CP. Although California allows the value of a business to be divided between SP and CP where the business was originally SP and appreciated during marriage, those rules (e.g., Pereira and Van Camp) will not apply here as the practice was established during the marriage. Thus, the value of the accounting practice that accrued until permanent separation is CP, and each of Hank and Wendy will be entitled to a one-half in kind interest therein.

However, here the facts state that Wendy's income from the accounting practice tripled after the separation. All property acquired after permanent separation is SP, including labor and wages of each spouse. Thus, Wendy's increased income post-separation and the post-separation increase in value to the accounting practice (because attributable to Wendy's labor) will be Wendy's SP and Hank will not have any interest therein.

c) The office building?

To determine Hank's and Wendy's rights, if any, in the office building, we must determine whether the office building is CP and whether any subsequent action altered that characterization.

The office building was purchased by Wendy in 2012 with funds from her earnings during marriage and she took title in her name. Under California law, all property acquired during marriage is presumed to be CP even if titled in one spouse's name. Here, we know that Wendy purchased the office building with her earnings during the

marriage. Under California law, such earnings are CP. Thus, because the office building was purchased with CP it will be CP notwithstanding that title is in Wendy's name alone, the presumption that the office building is CP will not be overcome, and as of separation each of Hank and Wendy have a one-half in kind interest in it.

After separation, there are two issues to consider to establish Hank and Wendy's respective rights with respect to the office building.

After permanent separation, Wendy's earnings become SP. The issue is whether Wendy's. Under California law, when CP is improved with SP, the property remains CP but the SP is entitled to a right of reimbursement from the community. Here, after separation when Wendy remodeled the office building with her increased earnings, she was entitled to reimbursement from the community for any increased value to the office building that resulted.

Wendy subsequently sold the office building to Bob, who did not know she was married. The issue is whether that sale is valid or whether it can be rescinded. Under California law, both spouses have equal rights to manage and control CP. Thus, one spouse may not dispose of a piece of CP without the permission of the other spouse. Where, as here, one spouse sells CP without the consent of the other, the sale may generally be rescinded within the first year, unless the sale is made to a bona fide purchaser. A bona fide purchaser ("BFP") is a purchaser for value who takes without notice of the claims of any other person. In the context of community property, to be a BFP a purchaser must not know that a seller is married. Here, we know that Bob did not know Wendy was married and the deed was in her name alone. Thus, he did not have notice of Hank's interest in the property and will be a BFP. Because Bob is a BFP, the sale cannot be rescinded. Even so, Wendy will be required to reimburse the community for the purchase price (although, as noted before, she will herself be reimbursed for the value of her SP improvements).

Thus, although neither Hank or Wendy will have an interest in the office building itself, Hank will have a one-half interest in the purchase price of the office building (less the value of the remodeling, if any) and Wendy will have a one-half interest in the purchase price of the office building and a right to be reimbursed for the costs of the remodeling.

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ESSAY QUESTIONS AND SELECTED ANSWERS

JULY 2014

CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the July 2014 California Bar Examination and two selected answers for each question.

The answers were assigned high grades and were written by applicants who passed the examination after one read. The answers were produced as submitted by the applicant, except that minor corrections in spelling and punctuation were made for ease in reading. They are reproduced here with the consent of the authors.

Question Number	Subject
1.	Contracts/Remedies
2.	Evidence
3.	Business Associations / Professional Responsibility
4.	Criminal Law and Procedure
5.	Trusts / Community Property
6.	Torts

Question 5

Henry and Wynn married in 2000. During the first ten years of their marriage, Henry and Wynn lived in a non-community property state. Henry worked on writing a novel. Wynn worked as a history professor. Wynn kept all her earnings in a separate account.

Eventually, Henry gave up on the novel, and he and Wynn moved to California. Wynn then set up an irrevocable trust with the $100,000 she had saved from her earnings during the marriage. She named Sis as trustee and Henry as co-trustee. She directed that one-half the trust income was to be paid to her for life, and that the other one-half was to be paid to Charity, to be spent only for disaster relief, and that, at her death, all remaining assets were to go to Charity.

Wynn invested all assets in XYZ stock, which paid substantial dividends, but decreased in value by 10%. Charity spent all the income it received from the trust for administrative expenses, not disaster relief.

Later, Sis sold all the XYZ stock and invested the proceeds in a new house, in which she lived rent-free. The house increased in value by 20%.

Henry has sued Sis for breach of trust, and has sued Charity for return of the income it spent on administrative costs.

1. What is the likely result of Henry's suit against Sis? Discuss.

2. What is the likely result of Henry's suit against Charity? Discuss.

3. What rights, if any, does Henry have in the trust assets? Discuss. Answer according to California law.

QUESTION 5: SELECTED ANSWER A

1. Henry v. Sis

As discussed in #3, Henry does not currently have a personal interest in the trust assets. However, he is the co-trustee of the trust, and this may be sufficient to give him standing as trustee to bring an action against Sis for breach of her fiduciary duty as trustee.

Trust creation

To be valid, an express private trust must have a settlor, an ascertainable beneficiary, res, a valid purpose, and a trustee. However, the court will appoint a trustee if one is not provided for, or the elected trustee declines to serve. Here, Wynn is the settlor, and she has designated herself and Charity as lifetime beneficiaries, and Charity as the remainder beneficiary. Any natural person, entity or government can be a beneficiary of an express private trust. Both are ascertainable beneficiaries because they are either persons or entities expressly named in the trust instrument. The res can be any property or present interest. Here it is the $100,000 from Wynn's separate account. The trust appears to have two purposes: to provide lifetime income to Wynn; and to contribute to disaster relief via Charity. To be valid, a trust purpose must be able to be determined from the trust document, and must not be illegal. Neither of the purposes are illegal and are clear from the trust document. Wynn has designated Sis as trustee and Henry as co-trustee, and from the facts it does not appear that either declined to serve. They must be competent but there is no indication of incompetency in the facts.

Charitable trusts differ in that they must have a charitable purpose: something that contributes to societal good, such as abating hunger, education generally, religion, or the like. The beneficiaries of the trust must be indefinite, not a specific person. Here, because Wynn is a specific person, this could not be a charitable trust.

A valid express private trust was created.

Trustee powers

A trustee has the powers expressly granted in the trust document itself, and those implied in order to effect the purpose of the trust. Here, the trust instrument directed Sis to pay one-half of the income to Wynn, and the other half to Charity. This expressly gave her the power to make these distributions.

Trustee duties

A trustee has the duty of loyalty, to act for the benefit of the beneficiaries solely, and not in her own self-interest or that of third parties. This duty requires the trustee to be impartial as to multiple beneficiaries. Here, Sis has a duty to treat Wynn and Charity impartially. If this were a revocable trust, she would have a primary duty during Wynn's lifetime to Wynn as the settlor, but the trust is irrevocable.

As part of the duty of loyalty, a trustee has a duty not to self deal. Sis is living in the house owned by the trust, rent-free. Thus she is reaping personal benefit from her position as trustee. She has violated her duty of loyalty.

The trustee has a duty of care as well, which requires her to act as a prudent person would in handling their own affairs. This includes the duty to account regularly to the beneficiaries, and not commingle trust assets with her own.

As part of the duty of care, a trustee has a duty to invest the trust res as a reasonably prudent investor would. Under the traditional view, this limited the holdings of the trust to things such as blue chip stock, 1st trust deeds on real estate, government bonds and other conservative and safe investments. Each separate investment was considered separately in determining this. Modernly, the investments are looked at as a whole, and factors such as the need for income, tax consequences, and particular trust purposes are considered. Thus, the court will need to look at how Sis invested the trust res in light of whether the trust was intended more for lifetime income sources, or as a gift to

Charity at Wynn's death, at how the income would affect taxes, at what was reasonable as an investment in light of what was available to invest, at what reasonable investors were doing at the time.

Wynn originally invested the trust assets in XYZ stock, which provided substantial dividend income but lost value overall. This would seem to indicate a preference for lifetime income over growth of the principal.

Henry will need to be able to show that a reasonably prudent investor would not have sold the XYZ stock and invested it in a house. The sale of the stock itself may have been prudent given the loss in value. However, a trustee also has a duty to diversify in order to reduce the risk of loss and enhance income/growth opportunity, as would a reasonable investor. While the duty to diversify may have called for Sis to sell some or all of the XYZ stock, that same duty would generally preclude sinking all of the proceeds into one property. The trust res is then subject to any decline in real estate in the market, and will not benefit from any gains in other potential investments. Sis has probably violated her duty of prudent investment, and has certainly violated her duty to diversify.

The duty to make the res productive requires that Sis put the assets to work for the benefit of the beneficiaries. When she lived in the house rent-free, she violated this duty. The rental income from the house is to be distributed to Wynn and Charity, not retained for her benefit.

Sis has a duty to effect the purpose of the trust, by ensuring that income is maximized, based on the express and apparent intent of the settlor. She has not done so by selling the income stock and buying a house that currently provides no income to the trust.

Because Henry is currently subject to these same duties as co-trustee, he is obligated to prevent the wrongdoing of the other trustee. Thus he has standing to bring an action against Sis for her violations of duty, as a trustee of the trust.

Remedies available

The remedies available against a trustee who has violated their duties includes removal, surcharge for lost income/profits, disgorgement of any benefit wrongfully taken by the trustee. This benefit does not run to Henry, who is acting solely for the trust beneficiaries' benefit.

Henry will seek an accounting for the rent that should have been paid by Sis while living in the house owned by the trust. These funds must be paid personally by Sis. Additionally, he will seek surcharge for the lost income from the XYZ stock or similar investment that would have maximized lifetime income. Sis will have to make up the shortfall in income from her own funds.

Finally, Henry will seek removal of Sis as trustee. The court may then allow Henry to act as sole trustee or may appoint someone else.

Given Sis's breach of duty, the apparent purpose of the trust, the court will allow all of these remedies.

2. Charitable trusts are enforced by the attorney general, rather than by private action. If Charity is a charitable trust, Henry will not have standing to bring an action.

Assuming Henry has standing as the co-trustee of Wynn's trust, he can seek a constructive trust by tracing the funds from the trust to Charity as used for admin purposes. This will mean that Charity's sole duty as trustee of the constructive trust is to use the funds as directed.

3. California is a community property (CP) state. All property acquired during marriage while domiciled in CA or another CP state is presumed to be CP. All property acquired prior to marriage, or after separation, is presumed to be separate property. Additionally, all property acquired at any time by gift, descent, devise or bequest is presumed to be CP.

All property acquired during marriage while domiciled in a non-CP state that would be CP if domiciled in CA, is presumed to be quasi-CP (QCP). At termination of the marriage, to determine the character of property, a court will look at the source of the funds used to acquire property, any applicable presumptions, and any actions by the spouses that may change the character of the assets. A mere change in form does not alter the character of the asset.

Source:
Here, the source of the funds for the house, which is the sole trust asset, can be traced back to the XYZ stock and further, back to Wynn's earnings as a history professor. Because all earnings by community labor are CP, these earnings would be CP if the spouses had been domiciled in CA at the time they were earned. Thus, by definition, they are QCP (defined supra). During marriage, QCP remains the SP of the owning spouse. At divorce or death of a spouse, the character as QCP affects the property determination.

Presumptions:
All assets acquired during marriage are presumed to be CP. However, as noted, the source of the house is earnings that are Wynn's SP until termination of the marriage. Spouses can also take title in ways that raise a presumption, such as a gift to the community, which arises on death of a spouse under Lucas. However, Wynn kept the funds in a separate account, and then created an irrevocable trust with the funds, so no alteration in the title is shown in the facts.

Actions of the spouses
Spouses can by transmutation or other actions alter the character of their own SP. Henry may argue that the change from Wynn's separate account to a trust is such a transmutation. However, a transmutation, to be valid, must be in writing, signed by the adversely affected spouse and clearly express the intent to transmute. This is not evident here, so no transmutation has taken place.

Distribution of assets

At divorce, QCP is treated as CP, and this would entitle Henry to half of the QCP. Death also impacts the character, depending on which spouse dies. If the SP owner (Wynn) predeceases the non-owning spouse, the non-owning spouse may choose their forced share (take against the will) in order to get to QCP assets. However if the non-owning spouse dies first, they have no right to devise the QCP that belongs to the other spouse.

As a result, Henry has no immediate right in the trust assets. In the event of divorce or death of Wynn, he would acquire such rights as are discussed above.

QUESTION 5: SELECTED ANSWER B

1. What is the likely result of Henry's suit against Sis

A trustee owes fiduciary duties of loyalty and care to the beneficiaries of a trust. A trustee may bring suit against a co-trustee for breaching the fiduciary duties, and move to have the violating trustee removed from their position.

A. Duty of Care

Generally, a trustee owes a duty of care to the beneficiaries to act as a reasonably prudent person under similar circumstances. This includes the duty to prudently invest trust property in a manner that will create the greatest return for the benefit of the trust.

i. Prudent investment

A trustee has a duty to prudently invest trust funds so as to increase the benefits from investments for the trust beneficiaries. Here, Sis sold all of the XYZ stock in the trust and used the proceeds to pay for a house. Sis will argue that this is a prudent investment because XYZ stock had decreased in value by 10%, whereas the value of the house has appreciated 20%. This increased the value of the trust property. However, Henry will likely argue that to tie up all of the trust assets in one piece of property which potentially can fluctuate wildly in the real estate market is not a prudent investment. Instead he will argue that Sis should have diversified to different stock from other companies other than XYZ in order to keep a more stable and broad base for the trust property.

Based on these arguments, it is likely that Henry will prevail against Sis in arguing that exchanging all of the stock into one parcel of real property is not a prudent investment.

ii. Duty to diversify

A trustee also has a duty to diversify the stock held by the trust. Here, as discussed above, the trust initially only held XYZ stock. Henry will argue that Sis had a duty to diversify the stock to include stocks from other corporations, and that consolidating the trust assets into one piece of property which is less liquid and potentially subject to market fluctuations in price and value violated the duty to diversify.

A. Duty of loyalty

A trustee is a fiduciary and owes a duty of loyalty to the beneficiaries and the trustor of the trust. Therefore, Sis has a fiduciary duty of loyalty to act solely in the best interest for the trust.

i. Duty to avoid self-dealing

A trustee has a duty to avoid self-dealing with respect to trust assets. The trustee must obtain court approval before the sale of any property which benefits the trustee personally. Here, Sis sold all of the trust assets and used the proceeds from the sale to purchase a house in which she lives in rent-free. She is therefore using trust assets for her own personal benefit, which is impermissible absent court authorization. She has a duty to pay fair market rent to the trust for use of the property in order to avoid a claim of self-dealing.

Therefore Sis has arguably violated her duty to avoid self-dealing

ii. Fairness to all beneficiaries

A trustee also has a duty to act impartially and fairly towards both the income and the principal beneficiaries. The trustee cannot favor one beneficiary over another in terms of their investments or distributions. Here, whereas Wynn and Charity are both

income beneficiaries of the trust currently, Charity is the only principal beneficiary after Wynn's death.

(a) "Income"

Income beneficiaries are entitled to cash dividends from stocks, and rents from property held by the trust. Initially XYZ stock issued substantial dividends which are considered income to the trust and distributed to the income beneficiaries. Therefore Wynn and Charity were sharing the substantial income beneficiary. However, as noted above, the stock declined in value and therefore was worth 10% less, therefore reducing the future value for the principal beneficiary.

However, upon changing the stocks for the house, the principal beneficiary would obtain a 20% increase in value of the property. However, Sis is not paying any rent for the property, and therefore Wynn is no longer getting an income from the trust as a result of this change. This change, coupled with the lack of rental payments by Sis, means that Henry will likely be successful in arguing that Sis has violated her duty to act fairly and impartially towards both income and principal beneficiaries.

D. Conclusion

Because of the aforementioned breaches in duty, it is likely that Henry will prevail against Sis in claiming a breach of trust. The trust would likely be entitled to a constructive trust for the unpaid rent that was due on the propety, and Henry may have Sis removed as trustee for breaching her duties of care and loyalty.

2. What is the likely result of Henry's suit against Charity for return of the income

A. Purpose of a charitable gift

A trust must have a valid purpose in order to be properly formed. Here, part of the trust's express purpose at the time of formation was for income from the trust to be delivered to Charity but only go towards disaster relief. Charitiable contributions and trusts are considered valid purposes and therefore the trust is permissible.

B. Violation of a condition by a beneficiary

However, a violation by a beneficiary of an express condition of the trust violates the trust purpose. The court will look at the totality of the circumstances to determine whether the language was intended to merely express a wish on the party of the trustor, or rather if it is an express condition for receipt and use of funds. Here, the trust had an express condition that the share of income given from the trust to Charity was only to be used for disaster relief. However, the beneficiary here instead used the funds for administrative expenses, not disaster relief. The Charity will likely argue that it was only a general wish because they would receive the full benefit of the property upon Wynn's death and therefore should be able to use and dispose of trust income in any manner that benefits the charity. However, Henry will likley argue that the express terms of the trust are explicit in requiring that the funds only be spent on disaster relief. Therefore the beneficiary has violated an express term of the trust.

C. Remedy for violation by a beneficiary

If a beneficiary violates an express term of a trust, the trustee can sue for return of the income used in violation of the trust terms. Therefore Henry would likely prevail in a suit against Charity for return of the income.

3. What rights does Henry have in the trust assets?

All property acquired during marriage in CA is presumed community property (CP). However, property acquired by (1) gift or inheritance; (2) expenditure of separate property funds, (3) the rents, profits, or income derived from separate property; or (4)

acquired before the marriage are presumed to be separate property (SP) of the acquiring spouse.

A. Quasi-Community Property

If a married couple acquires property in a non-community property state that would have been community property had the couple been residents of a community property state, such items are considered "quasi-community property" (QCP) and are potentially subject to community property laws if the couple later moves to a community property state. During the marriage, the QCP is treated as SP of the acquiring spouse. However, upon divorce or death of the acquiring spouse, the QCP will be treated as CP and divided equally between the spouses. Upon the death of the non-acquiring spouse, the property will remain the SP of the acquiring spouse.

B. Wages earned during marriage

Wages, earnings, and pensions earned during marriage are considered CP, absent an agreement between the spouses agreeing otherwise. Here, Wynn earned a salary working as a history professor while living out of CA. Regardless of whether she kept the earnings in a separate account, in CA the earnings would be considered CP. The facts do not show that Wynn and Henry had any agreements changing the character of the property. Therefore upon moving to CA, Wynn's earnings are presumed to be QCP. However, as noted above, they retain their SP characterization until death or divorce.

C. The trust assets

Wynn and Henry are still married at the time that Wynn sets up the trust fund with $100,000 of her earnings. Even though these funds are earmarked as potential QCP, during the marriage they are still considered the SP of the spouse who earned them. Therefore at this time, Henry does not have any interest in the trust assets because of

the ongoing marriage. Henry will not have any possible rights to the trust assets until death or divorce.

Trust

ESSAY QUESTIONS AND SELECTED ANSWERS
JULY 2001 CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the July 2001 California Bar Examination and two selected answers to each question.

The answers received good grades and were written by applicants who passed the examination. The answers were prepared by their authors, and were transcribed as submitted, except that minor corrections in spelling and punctuation were made for ease in reading. The answers are reproduced here with the consent of their authors.

QUESTION 6

Ted, a widower, had a child, Deb. He had three brothers, Abe, Bob, and Carl.

In 1998, Abe died, survived by a child, Ann. Ted then received a letter from a woman with whom he had once had a relationship. The letter stated that Sam, a child she had borne in 1997, was Ted's son. Ted, until then unaware of Sam's existence, wrote back in 1998 stating he doubted he was Sam's father.

In 1999, Ted executed a will. With the exception of the signature of a witness at the bottom, the will was entirely in Ted's own handwriting and signed by Ted. The will provided that half of Ted's estate was to be held in trust by Trustee, Inc. for ten years with the income to be paid annually "to my brothers," with the principal at the end of ten years to go "to my child, Deb." The other half of the estate was to go to Deb outright. One month after Ted signed the will, Ted's second brother, Bob, died, survived by a child, Beth.

In 2000, Ted died. After Ted's death, DNA testing confirmed Ted was Sam's father.

What interests, if any, do Deb, Sam, Ann, Beth, and Carl have in Ted's estate and/or the trust? Discuss. Answer according to California law.

ANSWER A TO ESSAY QUESTION 6

In re: Estate of Ted (T)

I will first discuss the validity of the will, and then discuss the terms of the will, which includes the trust. Then I will discuss how the estate should be distributed, according to those terms, and then how that distribution would be altered by Sam's claims.

I. Validity of Will

Under California law, a valid will must be signed by the testator, signed or attested before two witnesses at the same time, who know the items in a will, and who then sign the will. Further, the testator must have the intent that this document be his will.

Here, while the will was signed by T, it was not properly witnessed -- it appears only one witness signed, and the law requires that two sign. Therefore, this will does not comply with will formalities.

However, this will is valid as a holographic will. Holographic wills are valid in California. A holographic will is one in which all of the material terms of the will -- testamentary intent, property to be distributed, and intended beneficiaries -- are all in the testator's handwriting (intent can be found as a commercially prepared will form, but that is not applicable here). Next, the holographic will must be signed by the testator.

Here, those requirements are met. The entire will was written by T (under the witness' signature), so the material portions are in T's handwriting (he expressed his intent, disposed of his property, and named his beneficiaries) and he signed the will.

II. Terms of the Will

Half of the estate goes to Deb (D). The other half goes to the trust.

A trust is a disposition of property which separates equitable title, held by the beneficiaries, from the legal title, held by the trustee. The trustee must manage the trust for the benefit of the beneficiaries.

A. Validity of Trust

For a trust to be valid, there must be: 1) a trustee; 2) funding of the trust; 3) ascertainable beneficiaries; and 4) no violation of public policy.

Here, a trustee has been named -- Trustee, Inc. Even if Trustee, Inc. is not actually still in existence, the trust will not fail. Trusts do not fail for want of a trustee -- the court will just name one.

Next, the trust has ascertainable beneficiaries. The trustee must be able to identify the

recipients of the trust. Here, Deb may argue that the beneficiaries are not ascertainable because none are listed by name. However, here there is a class gift. T left the income of the trust for 10 years "to his brothers." A trustee can identify his brothers.

D may argue this class gift violates the Rule against Perpetuities. Under the rule, an interest must vest if at all with 21 years of a life in being at execution. Here, D would argue that T could still have more brothers. However, at T's death, the class closes due to the Rule of Convenience, so the interest vests.

Next, the trust is funded by the transfer from the will to the trust at death. This is called a testamentary trust and is valid.

Finally, there is no improper purpose for this trust. Therefore, the trust is valid.

III. Distribution

Here, I will discuss the distribution as if Sam's claims are denied. I will discuss the impact of his claims on this distribution later.

A. Deb's ½ of Estate in the will

Deb takes this share outright.

B. Distribution of trust.

As discussed above, the income of the trust is distributed to T's brother for ten years. The issue is which brothers or their issue share in this class gift.

When T died, Carl was still alive, and Abe and Bob had already died. Carl will argue that he is the only surviving member of this class, so he takes the ½ interest outright. He would argue that Abe and Bob's interests had lapsed, and so failed.

However, California has an anti-lapse statute. Under the statute, if: 1) the dead beneficiary was related to the testator, 2) the dead beneficiary was survived by issue, and 3) there is no contrary intent, then the dead beneficiary's issue represent him and take his share. In California anti-lapse also applies to member of a class gift, unless a member of that class died before execution and the testator knew that.

Here, Bob died one month after T executed the will, so he qualifies for anti-lapse application under the statute. Further, Bob satisfies the statute -- he is related to T (his brother), he is survived by issue (Beth) and there is no contrary intentions in the will, like a survivorship clause. Therefore, Beth joins Carl in the class.

However, Abe died before execution of the will, and provided T knew this, which he probably did because people usually know when their siblings die, Abe does not qualify for protection under the statute because he fails the class gift requirements. Therefore, even though Abe

satisfied the statute, Ann cannot avail herself of the statute and so will not join the class.

Therefore, Carl and Beth are entitled to the income from the trust for 10 years. Once the ten years are up, Deb gets the principal and therefore, the entire estate.

IV. Sam's Claims

Sam, if he can prove he is T's son, has several claims.

First, Sam must prove he is T's son. During life, Sam could prove paternity by admission of T, being listed on a birth certificate with T as father, or by being born in marriage between his mom and T. Here, during T's life paternity was never established. T wrote back to Sam's mom saying he doubted he was Sam's father, and T was unaware Sam existed, so they never held out a relationship.

After death, paternity can be proven, but it must be by clear and convincing existence. Here, DNA confirmed T was S's father, which is convincing and clear evidence, so Sam can pursue the following claims.

1. Pretermitted Child

By statute, a child born after execution of a will can take an intestate share if he was not taken care of in the will, outside of the will, there is no contrary interest, and the parent did not leave most of the estate to the surviving spouse.

Here, S was born in 1997. T learned of this in 1998. T executed his will in 1999. Therefore, because T executed his will after S was born, S cannot avail himself of this statute.

2. Unknown Child

By statute, a child born before the will was executed, who was not provided for in the will or outside the will in other instruments, is entitled to an intestate share if the testator did not know of the child's existence, and did not provide for the child because of that belief, either by mistakenly believing the child was dead or never born.

Deb will argue that T knew of Sam's existence when he executed the will. T received a letter in 1998 telling him he was Sam's dad. Therefore, Sam cannot qualify under the statute.

Sam will argue that, although T knew Sam existed, he did not know Sam was his child. This proof did not come out until after T died, with the DNA testing. Sam will argue that had T known S was his child, T would not have omitted him.

However, that belief must be the but/for cause of the omission. Here, it appears that T was not interested in Sam -- he made no attempt to determine paternity, or to establish a relationship with Sam, so Sam cannot qualify under this statute.

If he did, he would get an apportioned share of the entire estate.

ANSWER B TO ESSAY QUESTION 6

Validity of Will: CA recognizes the validity of wills that are valid under CA law or the law of other states where a person executed the will. I will assume Ted died and executed his will in CA.

CA recognizes attested, statutory and holographic wills. A holographic will must be signed by the testator and the material provisions in the handwriting of the testator. Here, Ted signed the will and the entire will, which would include material provisions, was in his handwriting. Therefore, the will is valid.

Validity of Trust: A will may create a trust. Ted's will created a trust. A trust must have: (1) settlor with capacity. Ted is a settlor and has capacity. (2) Present intent to create: Ted intended [that] his will create the trust. (3) Trust property existing and ascertained. Ted's estate meets this requirement. (4) Beneficiaries existing within the rule of perpetuities. All Ted's provisions require that beneficiaries take within 10 years. Therefore, all beneficiaries will be existing within the Rule Against Perpetuities, and (5) Valid Purpose: A trust for relatives is a valid purpose. Further, Ted already has a trustee. The trust is valid.

Ann, Beth and Carl:
Carl: Carl definitely takes a share of the trust income because he is a surviving member of a named class: "Ted's Brothers." The share he takes, however, depends on the claims of everyone else.

Beth: Any rights Beth have come from her father, Bob. Bob predeceased Ted. Therefore, Bob and his issue do not take under the instrument. However, Beth may take under CA Anti-lapse, which states: if a beneficiary predeceases the Testator (Note: Anti-lapse applies to all testamentary instruments including trusts), that person's issue takes his share unless a contrary intent. Class gifts are included in Anti-lapse. Therefore, Beth will take her father Bob's share. (See Ann for more Anti-lapse)

Ann: Same analysis except as Abe's daughter as Beth until Anti-lapse. Another exception to anti-lapse is that if a class gift is made and one member of the class is dead when made, anti-lapse does not apply to that person if testator knew he was dead.

Here, Ted likely knew his brother Abe was dead (Abe died in 1998) when he made his will in 1999. Plus, Abe is a member of a class gift. Therefore, Ann will not take unless Ted did not know of Abe's death; then she will take his share of anti-lapse.

Deb: Deb will take the shares described in the instrument because the trust and will are valid. However, her share may be altered by Sam's claims.

Sam: Sam will not take under the instruments. Sam may take under CA's Omitted Child

Provisions. Since Ted died in 2000, the omitted child provisions apply to all testamentary documents.

An omitted child is a child: born after execution of the instrument(s), thought dead, or not known by testator to be born.

Here, Ted knew of Sam, but did not know Sam was his child. However, after execution of the instrument(s) and in fact after Ted's death, DNA proved Sam was the child of Ted. Therefore, Sam may qualify as constructively being born after execution or that he was not known to be born. One of these arguments should work because as to Ted Sam was not known to be born.

Therefore, the omitted child provision should apply unless Ted provided for Sam outside the instrument, intended to exclude or gave most property to the surviving parent.

Deb will argue that Ted intended to exclude Sam because Ted knew of Sam and doubted that he was Sam's father. Deb's argument likely fails because Ted never knew Sam was his child and neither of the other exceptions even remotely qualifies.

Therefore, Sam will very likely take his omitted child's share, which is his intestate share.

Sam's Intestate Share: Since Ted had no surviving spouse, his issue are his intestate successors. Ted had two issue, Deb and Sam. The intestate share is ½ of Ted's estate each. However, since Deb takes under the will, she does not take under intestacy.

Sam's Share: ½ the estate prior to it going into the trust or to Deb if he is an omitted child. If not, he gets nothing.

Summary:
1. Beth and Carl likely split the trust income for 10 years unless Ted did not know of Abe's death. In that case, Ann, Beth and Carl split the income.

2. Deb takes the principal of the trust after 10 years and ½ the estate outright subject to Sam's interests.

3. Sam likely takes ½ the estate before any other dispositions are made. Or he takes nothing.

California Bar Examination

Essay Questions and Selected Answers

February 2002

Question 4

Richard, a resident of California, created a revocable, inter vivos trust in 1998 at the urging of his wife, Alicia, who was also his attorney. Alicia drafted the trust instrument.

Richard conveyed all of his separate property to the trust. The trust instrument named Alicia as trustee with full authority to manage the trust and invest its assets. By the terms of the trust, Richard was to receive all of the income during his life. Upon his death, his child by a former marriage, Brian, and Alicia's daughter by a former marriage, Celia, would receive for their lives whatever amounts the trustee in her discretion thought appropriate, whether from income or principal. Whatever remained of the principal on the death of the last income beneficiary was to be divided equally among the then-living heirs of Brian and Celia. Celia was included as a trust beneficiary only after Alicia convinced Richard that this was necessary to avoid a possible legal action by Celia, although Alicia knew there was no legal basis for any claim by Celia.

Celia had lived with Alicia and Richard from her 10th birthday until she graduated from college at age 21 in 1990. Although Richard had once expressed an interest in adopting her, he was unable to do so because her natural father refused to consent. After Celia's college graduation, however, she rarely communicated with either Richard or Alicia.

After creation of the trust, and while Richard was still alive, Alicia invested one-half of the trust assets in a newly-formed genetic engineering company, Genco. She lent the other one-half of the trust's assets at the prevailing market rate of interest to the law firm of which she was a partner.

Richard died in 2000, survived by Alicia, Brian and Celia. Brian, upset with the way Alicia has handled the trust assets, seeks to have the trust declared invalid or, in the alternative, to have Alicia removed as trustee and require her to indemnify the trust for any losses.

1. What grounds, if any, under California law can Brian assert for invalidating the trust, and what is the likelihood Brian will succeed? Discuss.

2. What grounds, if any, under California law can Brian assert for removing Alicia as trustee and requiring her to indemnify the trust, and what is the likelihood Brian will succeed? Discuss.

3. As an attorney, independent of her capacity as trustee, has Alicia violated any rules of professional responsibility? Discuss.

ANSWER A TO ESSAY QUESTION 4

Part 1. Grounds Under California Law Which Brian ("B") Can Assert for Invalidating the Trust and Likelihood of Success

The issue is whether B can assert that the trust created by Richard ("R") pursuant to California law suffered legal defects in its creation so as to invalidate the trust. In order for a trust to be validly created, the settlor must deliver trust assets (res) to a Trustee for the benefit of certain beneficiaries for a valid legal purpose. According to the facts a trust instrument was executed, which satisfies any statue of fraud issues, whereby R, the Settlor, conveyed its separate property to the trust. Thus, the res requirement has been met. A California court will not invalidate a trust for lack of a trustee, but where there is only one trustee and such trustee is also the only beneficiary. Here, R named Alicia ("A") as Trustee, and the beneficiaries are initially, R, then B and Cecilia ("C"), and then others. The last legal hurdle is that the trust must have a valid legal purpose. In the instant case, the purpose is valid, since it does not restrict actions frowned upon by the law, such as prohibition of marriage.

According to the facts, R's trust was validly created. B's best argument for invalidating the trust is that R lacked the testamentary capacity and intent to create the trust because of (1) undue influence and (2) fraud. B is likely to succeed on this basis. With respect to undue influence, B will point to extrinsic evidence that A, an attorney, drafted the trust instrument and urged R to create the trust. Pursuant to common law, beneficiaries of a trust or will is (sic) prohibited from drafting the trust, unless they are related and live in the same house. This exception is met, since A is R's wife and lives with R, though A should have sought outside counsel to review the instrument. For B to succeed on a claim of undue influence, B would have to show that but for a strong influence, R would not have entered into a trust and made the specific distributions outlined therein. Given the facts, it would be difficult for B to succeed in proving undue influence.

B's other cause of action, which is much stronger, is fraud in creation of the trust. For a claim of fraud, B would have to prove that A intentionally made a misrepresentation of fact to induce R to enter into the trust, and that R relied on such representations. These requirements are met in this case. The facts show that C was included as a trust beneficiary only after A convinced R that this was necessary to avoid a possible legal action by C, although A knew there was no legal basis for such a claim. A clearly misrepresented law and had the necessary scienter to induce R to include C, a stepdaughter that (sic) was not formally adopted or acknowledged as a daughter by R, as a beneficiary to the trust. Because the requirements for fraud are met, B would likely succeed in invalidating the trust or at least the provision in the trust benefiting C.

Part 2. Grounds under California Law B can assert for removing Alicia ("A") as Trustee and Requiring A to indemnify the Trust; and Its Likelihood of Success

A's powers as a trustee can be expressly granted in the trust instrument or implied. In addition, A as the trustee has fiduciary duties, mainly a duty of care and a duty of loyalty. Because the trust does not specifically discuss A's powers, we must look to A's duties of care and loyalty. A's duty of care, which has been described as the prudent investor rule, requires that A exercise the degree of care, skill and prudence of a reasonable investor investing his or her own property. The prudent investor rule requires the trustee to, among other things, diversify trust assets and avoid risky investments while keeping the income production potential of the trust.

In the present case, A violated her duty of care to R and the other beneficiaries, including R. A invested 50% of trust assets in a newly-formed genetic engineering company, Genco, and the other 50% in the form of debt at the prevailing market rate of interest to the law firm of which she was partner. Both of these investment decisions are not decisions that prudent investor would decide upon. First, A did not diversify the trust's assets as exemplified by the 50% and 50% investments. Second, the investment in a (sic) Genco a newly-formed company without publicly disclosed operating results for a period of time is a very risky investment. Most financial institutions and prudent investors would advise investors to avoid shares of new companies because they lack operating results and many years of public reporting of financial results. A violated this

basic rule in investing 50% of the corpus into a newly-formed genetic engineering company. The facts do not indicate that Genco is a public company, which compounds the riskiness of this investment since private companies are not subject to many of the accounting and financial restrictions and disclosures that are intended to protect investors. Lastly, A invested the remaining 50% of the funds as debt to a law firm at prevailing interest rates. All things equal, this investment is more risky than placing the funds at a bank which is generating the same amount of interest. If the latter option is available, A also breached A's duty of care by not investing R's separate property into a less risky investment.

B can also claim that A violated her duty of loyalty. The duty of loyalty requires that the Trustee has undivided loyalty to the trust and may not enter into transactions with the trust that will detriment the beneficiaries. In the instant case, A made a loan of trust assets to the law firm where A is a partner. As discussed in the previous paragraph, this is to the detriment of the beneficiaries since safer investments and possible more profitable investments existed.

Because A violated her duties of care and loyalty, B has a strong claim for removing A as trustee and requiring her to indemnify the trust. Where a trustee has violated these duties, not only may the trustee be removed, the beneficiaries can see (1) to ratify the transactions made by the trustee, (2) impose a surcharge on the trustee (i.e, indemnify the beneficiaries for losses) or (3) trace trust assets and recover such asset. Because we do not know the results of A's investments in Genco and in the loan

to her law firm, we cannot recommend a specific course of action to B; however, since B seeks to have A indemnify the trust for losses, B will clearly have such option at his disposal, In addition, the court will not hesitate to remove A as trustee for lack of another trustee specified in the trust instrument, since the Court has power to appoint another trustee.

Part 3. Possible Violations by A of the Rules of Professional Responsibility

As an attorney, independent of her capacity as trustee, A has violated many rules of professional responsibility. First, A has a duty of loyalty to R, which means that A should act in the best interest of R, her client, and her own personal interests should not adversely affect her representation. If such personal or other interest affects her representation, A can only represent R if she reasonably believes that her personal and possible conflicts of interest will not adversely affect her representation of R and R is advised of the situation with consultation and consents. Pursuant to California Law, such consent should be written. According to the facts of this case, A had a potential conflict, since A was named a trustee and A's daughter was a beneficiary. This was not a potential conflict, but an actual conflict. In addition, A did not seek R's consent or advise him of the conflict. In fact, A was well aware of the conflict and intentionally lied to R so that R would include C as a beneficiary and continued to draft the trust instrument. When apprised of such a conflict, A should have withdrawn or asked R to seek another attorney for representation (or at least an outside attorney's opinion on the

trust instrument). Because of this conflict of interest, A has violated her duty of loyalty to R.

A also violated her duty of competence. A lawyer should have the legal knowledge, skill, preparedness and thoroughness necessary to protect his or her client's interest. In this case, A did not possess such knowledge as reflected by her advice to R. A should have withdrawn as R's attorney given the conflict of interest and not have advised R as to the legal consequences of not including C.

Lastly, A committed misconduct since A has duty not to lie and defraud clients. As an officer of the court, A should not have intentionally abused her role [as] a lawyer to R by telling him that it was necessary to include C in the trust. This intentional misrepresentation of the law is misconduct that is violative of the rules of professional responsibility.

Because of these violations of the rules of professional responsibility, A should be censured for her actions.

ANSWER B TO ESSAY QUESTION 4

1. Brian's Grounds to Invalidate the Trust

At his wife's urging, Richard created an express inter vivos trust of his separate property, which allowed him the income from the property for the remainder of his life, and at his death to go to his children. Brian can argue (1) that the trust was not validly formed, (2) that Alicia exerted undue influence over Richard and overcame his will in his disposing of his separate property in the trust at his death, (3) that the trust is voidable because of Alicia's misrepresentation to Richard regarding Celia.

Trust Requirements

Brian could first attempt to argue that the inter vivos trust was not validly created.

Under California law, a valid inter vivos trust requires (1) intent to create a trust, (2) delivery of the res (including constructive delivery), (3) a res (property to be placed in the trust **B**trust assets), (4) named ascertainable beneficiaries, (5) a trustee, and (6) a valid lawful purpose.

In the present case, it appears that the requirements for a valid trust have been met. Although Richard created the trust at the urging of his wife, it appears that he did in fact intend to create the trust. Additionally, his separate property was transferred to the trust as the res, Brian and Celia and their heirs were named ascertainable beneficiaries,

Alicia was named as the trustee, and the trust purpose (providing for Richard's children) is a lawful one. Therefore, the trust appears to have facially met the requirements for a valid trust.

Undue Influence

However, Brian will assert that the trust is void because Alicia exerted undue influence (1) by urging Richard to create the trust of his separate property, and (2) by convincing him against his will to leave trust property to his stepdaughter Celia.

Under California law, a testamentary disposition is void if it was the result of undue influence. In order to prove undue influence, Brian has the burden of showing (1) that Alicia exerted influence over Richard, (2) that Richard's will was Aoverborne@ by Alicia's influence, and (3) that but for the influence, the disposition would have been different. However, proof that a party had the ability to influence the testator, as well as the motive, is not sufficient in an[d] of itself to demonstrate undue influence.

In the present case, Alicia urged Richard to create the trust of his separate property. This fact demonstrates that she did attempt to exert influence over him, but there are no facts indicting that Richard's will was overborne by this urging, or that he did not already desire to create the trust of his own will.

Additionally, Richard did not want to include Celia in the trust, but Alicia convinced him to do so because he might be sued if he did not. This is a much closer call, because in

this case, Alicia exerted influence by giving faulty legal advice to Richard, he changed his mind based solely on the influence, and but for Alicia's self-serving advice, he would not have included Celia in the trust. If the Court or finder of fact believes that Alicia exerted undue influence, then the inclusion of Celia in the trust would be void, and the trust may potentially be declared invalid.

Misrepresentation

Brian will also argue that Alicia's misrepresentation regarding Celia was fraud in inducing Richard to crate the trust and include Celia in it.

In order to demonstrate that the trust was based on misrepresentation, Brian must show (1) that Alicia made a material misrepresentation to Richard, (2) that Alicia knew the information was false, (3) Richard in fact relied on the misrepresentation, (4) that Richard's reliance was justifiable, and (5) damages.

In the present case, Alicia knew that Celia did not have grounds for a legal action against Richard, and yet she still told Richard that he should include her in the trust to avoid a lawsuit. Richard relied on this advice because he did in fact include Celia in the trust, and his reliance was justifiable given that his wife was an attorney and he was not, so he reasonably trusted her legal advice. The damages in this case result from the fact that Celia was wrongfully added to the trust.

Based on this misrepresentation, it will be a close call whether the entire trust will be found void, or whether the provision regarding Celia will be declared invalid. It appears that Richard intended to crate a trust for the benefit of Brian and his heirs, and that he originally intended to crate a trust before the misrepresentation. Therefore, the gift to Celia would likely be declared void based on the misrepresentation, but the trust itself would likely not be revoked.

2. Removal of Alicia as Trustee and Indemnification

Alicia invested half the trust assets in a new biotech company and loaned the other half of the trust assets to her law firm. Based on her actions as trustee, Brian has several arguments that she should be removed and that she should be forced to indemnify the trust.

Powers of Trustee

Under the common law, a trustee was entitled to buy or sell trust assets, but was not entitled to borrow for the trust or loan funds from the trust. However, under the modern trend, the trustee is entitled to loan or borrow funds for the benefit of the trust under certain circumstances.

Brian could argue that Alicia exceeded her duties as trustee because she was not empowered to loan trust assets, but nonetheless loaned funds to her own law firm. However, because under the modern trend a trustee is entitled to loan trust assets,

Brian will likely lose this argument. (However, see discussion below regarding self-dealing/duty of loyalty regarding loan to Alicia's law firm.)

Duty to Diversity Trust Assets

Brian would also argue that Alicia violated her duty as trustee to diversify the trust assets. A trustee has an obligation to diversify the trust assets to keep them from being depleted.

In the present case, Alicia invested half of the trust assets in one risky company, and loaned the other half to her own law firm. In doing so, she failed to properly diversify the trust assets, and rant the risk that if one of the two investments lost money, the trust assets would be depleted. Therefore, Alicia violated this duty.

Duty to Avoid Speculation

Brian will also argue Alicia violated her duty to avoid speculation and risky investments of the trust assets. A trustee has an obligation to avoid speculating the trust assets or placing the assets in risky investments that might jeopardize losing the trust assets. Under the prudent investor rule, a trustee must act as a reasonably prudent person would do in managing their own business assets.

In the present case, Alicia invested half the trust assets in a speculative new biotech company. Regardless of whether Alicia actually believed that this was a good company, new and untested biotech companies are inherently risk investments. In

investing half the trust funds in this company, Alicia did not act as a reasonably prudent investor would do, and she violated her duty to avoid speculation.

Duty to Keep Trust Assets Productive

A trustee also has a duty to keep trust assets productive. In this case, Alicia loaned half the trust assets to her own law firm. There is no indication what kind of rate of return this loan will receive, but if it is not substantial, or if it is below what it would otherwise receive from being properly invested, Alicia has violated her duty to keep the trust assets productive.

Duty of Fairness

A trustee also has a duty of fairness not to favor one beneficiary over the other. In the present case, Celia is Alicia's daughter, and Brian is Richard's soon from a previous marriage.

Therefore, Alicia cannot favor Celia over Brian. Additionally, Alicia cannot attempt to invest in risky investments in order to benefit the trust assets during the lifetime of Celia (who has a lifetime interest in trust income), at the risk of jeopardizing the trust assets for future beneficiaries. By investing in risky investments for quick-profit (the biotech firm) it appears that Alicia is violating this duty.

Duty of Loyalty of Trustee

The main duty that Alicia violated is the duty of loyalty. A trustee has a duty not to self-deal trust assets or commingle trust assets with her own. In the present case, Alicia loaned half the trust assets to her own law firm, where she is a partner. Therefore, because she loaned money to an entity which she is an equity owner, she violated her duty to avoid commingling or self-dealing.

Damages

Brian has several options in receiving damages for Alicia's breaches of her duties as trustee. First, for any investment that Alicia made that benefitted the trust and were profitable, he can ratify those actions, and keep the proceeds. For any deals that Alicia made that lost money, Brian can surcharge the trustee, and she will be required to indemnify the trust for the losses. Finally, for any self-dealing, such as the loan to her law firm, Brian can trace the funds, and have them given back to the trust.

3. Alicia's Violation of the Rules of Professional Responsibility

Alicia violated several rules of professional responsibility.

Duty of Loyalty

First, an attorney has a duty of loyalty to the client to avoid conflicts of interest. A conflict of interest arises where an obligation or interest of the attorney, to a third party, or to another client is materially adverse or directly adverse to the client. If there is a

potential conflict of interest, the attorney can represent the client in that matter only (1) if the lawyer reasonably believes she can give the client effective representation, (2) the attorney informs the client of the nature of the conflict, (3) the client consents, and (4) the consent is reasonable.

In the present case, Alicia had a conflict of interest in serving as the trustee and in drafting the trust document for Richard because her own interest in providing for her daughter may affect her representation. (This was in fact demonstrated by the fact that she misinformed Richard of the law to include Celia in the will). Although there was a conflict, Alicia did not inform Richard of the conflict, Richard did not consent, and on the facts given, any consent he gave would have been unreasonable.

An attorney can also not create an instrument for the client that gives the attorney or close relative of the attorney a gift or devise. Alicia may have violated this duty by writing the testamentary trust that gave Celia, Alicia's daughter, an interest in the trust. Although there is an exception where the attorney is a relative of the client, this exception may not apply given Alicia's fraud and the devise to her daughter.

Duty of Competence

An attorney also has a duty of competence to the client to act vigorously and competently to advance that client's interests. Under this duty the attorney has an obligation to give competent legal advice, vigorously advance the client's interests, and not take a case if they will violate an ethical rule. Alicia did not advance Richard's

interests, and should have refused to draft the instrument because of her conflict of interest (discussed above).

Duty of Dignity and Decorum

Under the duty of dignity and decorum, an attorney has an obligation not to present false or misleading legal advice. Alicia violated this duty when she told Richard falsely that Celia would have a legal claim if she were not included in the will. This may also constitute tortious misrepresentation (see above).

ESSAY QUESTION AND SELECTED ANSWERS

JULY 2004 CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from July 2004 California Bar Examination and two selected answers to each question.

The answers received good grades and were written by applicants who passed the examination. The answers were prepared by their authors, and were transcribed as submitted, except that minor corrections in spelling and punctuation were made for ease in reading. The answers are reproduced here with the consent of their authors.

Question 3

Hank, an avid skier, lived in State X with his daughter, Ann. Hank's first wife, Ann's mother, had died several years earlier.

In 1996, Hank married Wanda, his second wife. Thereafter, while still domiciled in State X, Hank executed a will that established a trust and left "five percent of my estate to Trustee, to be paid in approximately equal installments over the ten years following my death to the person who went skiing with me most often during the 12 months preceding my death." The will did not name a trustee. The will left all of the rest of Hank's estate to Wanda if she survived him. The will did not mention Ann. Wanda was one of two witnesses to the will. Under the law of State X, a will witnessed by a beneficiary is invalid.

In 1998, Hank and his family moved permanently to California. Hank then legally adopted Carl, Wanda's minor son by a prior marriage.

In 2001, Hank completely gave up skiing because of a serious injury to his leg and took up fishing instead. He went on numerous fishing trips over the next two years with a fellow avid fisherman, Fred.

In 2003, Hank died.

In probate proceedings, Wanda claims Hank's entire estate under the will; Ann and Carl each claim he or she is entitled to an intestate share of the estate; and Fred claims that the court should apply the doctrine of *cy pres* to make him the beneficiary of the trust.

1. Under California law, how should the court rule on:
    a. Wanda's claim? Discuss.
    b. Ann's claim? Discuss.
    c. Carl's claim? Discuss.

2. How should the court rule on Fred's claim? Discuss.

Answer A to Question 3

3)

1. **UNDER CALIFORNIA LAW, THE COURT'S RULING ON:**

A. WANDA'S CLAIM

Wanda will argue that the will is valid and she is therefore entitled to at least 95% of Hank's estate, as described under the will.

1. Validity of the Will

a. Choice of Law

In order to determine whether the will is valid, it must first be decided what law will apply. The facts state that Hank dies while living in California. A will will be valid if it is valid in the state in which it was executed, the state in which the testator was domiciled at the time of execution, or the state in which the testator died. The will was executed in State X, and while Hank was domiciled in State X. Although the facts state the will would be invalid in State X, it is not necessarily invalid in California, the state in which Hank was living at the time of his death. The following is a discussion of the will's validity in California.

b. Requirements for an Attested Will

Under California law, for an attested will to be valid, it must be signed by the testator in the presence of two disinterested witnesses. An interested witness is one who is a beneficiary under the will. If a witness is "interested", the entire will is not invalid, but there is a presumption that the portion which the interested witnessed[sic] received is invalid.

Under the facts of this case, Wanda was to receive 95% of the estate. In addition, she was one of two witnesses to the will. Therefore, there is a presumption that the portion left to her is invalid. If Wanda cannot overcome this presumption, she will not be left with nothing; rather, she will still be entitled to her intestate portion under the will.

c. Wanda's Intestate Portion

Under intestacy, a spouse is entitled to receive all community property, and at least 1/3 and up to all of her deceased spouse's separate property, depending on whether or not the decedent left any surviving kin. In the present case, Hank left Ann and Carl. Where two children are left, the testator's estate is divided in 1/3 portions among the spouse and the two children. Therefore, Wanda will obtain 1/3 of Hank's remaining estate.

B. ANN'S CLAIM

1. Omitted Child

Ann will argue that she was an omitted child and, in the event the will is found valid in its entirety, other interests should abate and she should receive an intestate portion of Hank's estate. However, Ann will be unsuccessful in this argument because Ann was alive and known about prior to Hank's execution of the will, and she was not provided for on the will.

2. Intestate Portion

Ann will therefore argue that the aforementioned devise to Wanda is invalid and that she is in this way entitled to her intestate portion of the remaining interest. As discussed above, Ann will be entitled to 1/3 of Hank's estate through intestacy.

C. CARL'S CLAIM

1. Pretermitted Child

Carl will first argue that he was a pretermitted child, as he was adopted after the will was executed. Therefore, he will argue that, if the devise to Wanda is valid, her interests should abate to account for his intestate portion. However, the fact that Ann was excluded from the will harm Carl's interest, as this will evidence as intent not to devise any portion of his estate to his children.

2. Intestacy & Adopted Children

Therefore, Carl will argue that the devise to Wanda is invalid and that he should be entitled to a portion of the remainder of the estate through intestacy. The fact that Carl is adopted and not a child by Hank's blood will not affect Carl's portion because under California law, adopted children are treated the same in intestacy as children by blood.

2. **COURT'S RULING ON FRED'S CLAIM**

Hank's Will also included a trust. This is called a pour-over will. In order for the pour-over will to be valid, it must meet the requirements of a valid trust.

A. Validity of the Trust

1. Requirements

In order for a trust to be valid, it must have 1) an ascertainable beneficiary, 2) a settlor, 3) a trustee, 4) a valid trust purpose, 5) intent to create a trust, 6) trust property

(res), and 7) be delivered.

2. Lack of Trustee

The facts state that the trust lac[k]ed a trustee. The lack of a trustee, however, is not fatal, as a court can appoint a trustee to administer the trust.

3. Trust Property

The trust property is clearly identified in the will, as "five percent of my estate...to be paid in approximately equal installments over the 10 years following my death..." Therefore, this requirement is satisfied.

4. Delivery

The delivery requirement is met through the inclusion of the trust into Hank's will.

5. Unascertainable Beneficiary

The fact that the beneficiary is not named poses the biggest problem for the trust. In order for the trust to be valid, a beneficiary must be ascertainable. In the present case, the beneficiary is not named, but rather is described as "the person who went skiing with me most often during the 12 months preceding my death." Courts can use a variety of methods to ascertain the identity of a beneficiary when he or she is not specifically named on a will, such as: Incorporation by Reference or Facts of Independent Significance. Neither one of these are helpful in the present case.

Incorporation by reference allows a testator to incorporate into a will a document or writing if it is in existence at the time of the will, a clear identification is made, and the intent to incorporate is present. In the present case, the identity of beneficiary was not presently in existence. Therefore, this method fails to assist in ascertaining the beneficiary.

Facts of independent significance can also be used to incorporate outside items into a will. Although the identity of the person most frequently skiing with Hank would have independent significance, it is of little help here since Hank suffered a serious injury to his leg and thus gave up skiing. Therefore, this method also fails to assist in ascertaining the identity of a beneficiary.

When there is no ascertainable beneficiary, a resulting trust occurs. This means that the trust property returns to the settler's estate.

5. Cy Pres

Fred, however, will argue that under the doctrine of cy pres, the property should not

be returned to the settlor's estate, but should go to him instead.

Cy pres is a doctrine which provides that, where a charitable trust fails for lack of a beneficiary or other impracticality, the court should apply cy pres and grant the trust property to another charity which conforms with the trust purpose.

In the present case, Fred will argue that the purpose of the trust was to further leisurely sports and camaraderie. Fred will compare fishing with skiing, and argue that the two activities were similar in that they provided the opportunity for friends to come together and enjoy each other. Therefore, because it [sic] the two purposes are so similar, and because Fred went on numerous fishing trips with Hank, Fred will argue that he should be entitled to the trust property.

However, in order for cy pres to apply, the purpose of the trust must be charitable. Under the Statute of Elizabeth or the common law, this trust purpose, however Fred defines it, is not charitable. It does not alleviate hunger, help sick, further education, or health. Therefore, the doctrine of cy pres is inapplicable, and a resulting trust will occur. Therefore, the 5% will retain to Hank's estate and be divided among Wanda, Ann, and Carl accordingly.

Therefore, Fred will get nothing, and Wanda, Ann, and Carl will each get 1/3 of Hank's separate estate, and Wanda will get all of her and Hank's community property.

Answer B to Question 3

3)

1. Under California law, how should the court rule on:

a. Wanda

Wanda (W) claims that she is entitled to Hank (H)'s entire estate under the will. In order to make that claim, the will must first be proved to be valid.

Valid Will?

Choice of Law

The will was executed in State X, and under State X's laws the will would be invalid because a will witnessed by a beneficiary is invalid. W, as a beneficiary receiving the residue of H's estate, was one of the witnesses, and therefore the will would be invalid under the laws of State X.

However, the parties moved and became domiciled in California. Under California law, a will is valid if it complies with the statute of the place where the the will was executed, where the decedent was domiciled when the will was executed, or in compliance with the statute of the jurisdiction where the decedent was domiciled when he died.

Here, while the will is not valid under State X's laws, H was domiciled in California when he died. If the will is valid under California laws, then the will is valid and will be probated. A formally attested will to be valid in California must be in writing, signed by the testator or a third party at his or her direction, in the presence of two witnesses, and the witnesses understand what the testator is signing is his or her will.

Here, the will is valid under California law. First, the will is in writing, and it was executed by H. Further, two witnesses signed the will (but please see "interested witness" below), thus meeting that requir[e]ment. Presuming that the witnesses understood that what H was signing was his will, then California will formalities have been complied with.

Interested Witness

It is important to note that California does not invalidate a will because one of the witnesses is a beneficiary under the will. A witness is interested if the witness will directly or indirectly benefit from the will. If there is a necessary interested witness, California validates the will, but there is a presumption that improper means were used by the interested witness to obtain the gift. A witness is necessary if without her there is only one other witness. If the interested witness overcome[sic] the presumption, she will take under

the will. If, however, the presumption cannot be overcome, then she will only get to take her intestate share of the estate, and no more.

Here, W was an interested witness because she is taking under the will. Further, W was necessary to make the will valid because without her signature, there was only one other witness. Therefore, a presumption of improper influence arises. However, W should be able to easily overcome this presumption. W, being the wife of H, is a natural object of H's bounty. Common sense would dictate that W would receive a substantial share of H's estate. If W can provide some evidence that they had a good relationship, and that he had told her she would get a good share of her estate, that should be enough to overcome the presumption.

Intestate Share

Even if W is unable to overcome the presumption, W is entitled only to her intestate share. However, W's intestate share would be a sizeable share. W would be entitled to H's ½ of the community property and quasi-community property. Community property is that property acquired during marriage while the parties were domiciled in California. Here, this would include all the property acquired through the earnings of H and W and the rents, issues, and profits therefrom, since 1998 when the parties were domiciled in California through H's death in 2003.

W would also be entitled to ½ of the quasi-community property. Quasi-community property is property that was acquired while the parties were domiciled elsewhere that would have been community property had the parties been domiciled in California. Therefore, all property acquired during the marriage between 1996 and 1998 would be quasi-community property. Upon the acquiring spouse's death, that property would go to the surviving spouse. Because W would already own ½ of the community and quasi-community property, W would end up with all of the community and quasi-community property at the end.

Regarding H's separate property (sp), H has the power to dispose of all of his separate property as he sees fit. However, W, as H's surviving spouse, would be entitled to an intestate share of H's separate property if she cannot overcome the presumption. In California, if the decedent dies without any issue, then the sp goes all to the surviving spouse. If he dies with one issue or parents or issue of parents, then the surviving spouse gets ½ of H's sp. If the spouse dies with two or more issue (or issue of a predeceased issue), then the surviving spouse gets 1/3 of H's sp.

Here, H died with two issue surviving- Ann and Carl. Therefore, W's intestate share of H's sp would be 1/3 of all separate property.

Therefore, even if W is unable to overcome the presumption of improper influence, she still will be able to obtain quite a bit of property because of the intestate succession

laws.

In Other Claims

F's claim will be discussed below, as well as C's and A's claim. This is just to note that if all of these three claims fail, then W will take the entire estate of H, both sp and cp. However, if any of these claims do not fail, then W will not get to take the entire estate because the claimant will be entitled to whatever stake his or her claim had.

b. Ann's Claim

A's claim will be based on California's pretermitted child statute. A, a child of H, was left out of H's will. Under the pretermitted child statute, a child that is born or adopted after the will or codicil is executed, and is not mentioned in the will, will be able to receive an intestate share of the decedent's estate, unless the decedent made it clear in the will that a pretermitted child will not inherit, the child is being supported outside of the will, or the decedent has another child and leaves all or substantially all of his estate with the parent of that child.

Here, A's claim will fail because she was alive when H executed his will, and H did not include her in the will. The only exceptions to this rule are if the decedent thought the child is dead or did not know the child existed. Neither of these two are applicable here. H and A lived together in State X, so it is clear that H knew of A and did not think she was dead. A's claim for an intestate share will fail because she was not a pretermitted child.

c. Carl's Claim

C's claim will also be on the pretermitted child statute. Please see immediately above for a discussion on the statute. Here, C was a pretermitted child because he was adopted after H's will was executed. For an adopted child the time is when the child is adopted, not when the child was born. Therefore, unless one of the three exceptions applies, C will receive an intestate share.

First, there is nothing in the facts indicating that the H's will says he won't take. Second, there is nothing demonstrating that C is provided for outside of the will.

However, H does have one child surviving (A), and all or substantially all of the assets are being given to the parent of C, W. Under the third exception, C will not be able to receive an intestate share. C may argue that A is not a child of W. However, the statute says that if the decedent has one child, and the assets are given to the parent of the child claiming, then the exception applies. Here, because those two requirements are met, C will not be entitled to an intestate share. Note that if the statute said the other child living had to be the child of the parent receiving the assets, then the exception would not apply and C would receive an intestate share.

2. Fred's Claim

Fred (F)'s claim depends on whether there was a valid private express trust, and if so, whether the doctrine of cy pres even applies to this trust.

Valid Trust

A trust must have trust property, a trustee, beneficiaries, manifestation of intent by the testatory, creation, and a legal purpose.

Property

First, there is trust property because the will says the property will be 5% of H's estate.

Trustee

Second, there is no trustee named. While a trust must have a trustee, a trust will not fail for want of a trustee. Therefore, a court will appoint someone to be the trustee.

Beneficiary

Third, there is an issue as to whether there is a definite and ascertainable beneficiary. In a private express trust, there must be a definite and ascertainable beneficiary. From the face of the will, there is no beneficiary, and so this may be a problem for F. F will want to resort to other methods to prove it was him.

Integration nor incorporation by reference will not work because both require a writing or document, and there is no writing or document here.

However, F may be able to prove himself under the doctrine of facts of independent significance. The question here is: Would this fact have any independent significance other than the effect on the will? If the answer is yes, then parol evidence may be introduced and that fact will become part of the will. Here, F can make a good argument that whoever is fishing (or skiing) with H the most before his death is a fact that has independent significance outside the will. H will be fishing (or skiing) with this person because they like each other's company, a fact that is significant outside the will. Therefore, F should be allowed to introduce evidence that he was the beneficiary under this doctrine.

But note- if F is not really the beneficiary because he does not meet this requirement, then this trust will fail for lack of beneficiary (please see below, towards the

end).

Manifestation of Intent by Settlor

H, the settlor, clearly had the present intent to create a trust when he executed his will. The terms of the will, using words of direction directing the trustee to pay the beneficiary. Thus, there is sufficient intent.

Creation

A trust may be created either inter vivos or testamentary. A testamentary trust is a trust that is contained in a will. In order for a testamentary trust to be valid, the will must have been executed with the proper formalities.

Here, H has created a testamentary trust by placing the trust in the will to take effect upon H's death. As discussed above, the will was properly executed under California's will statute. Therefore, there was sufficient creation.

Legal Purpose

A trust must serve a lawful purpose. Here, there is a lawful purpose in giving a beneficiary an installment of money over a period of ten years. Nothing in this trust is unlawful.

Therefore, all of the requirements for a trust have been met and there is a valid trust.

Cy Pre[s]?

The trust's terms specially said that the payments would go to whoever was skiing with H the most during the last 12 months of his life. F fished with H the most during the last 12 months of H's life, and now seeks to have the doctrine of cy pre[s] apply.

The doctrine of cy pres applies to charitable trust, when the settlor had a general charitable intent, but the mechanism for expressing the intent has been frustrated. If this is the case, the court will order a new mechanism to express the settlor's charitable intent.

Charitable Trust?

A charitable trust is a trust created for the benefit of society, for such purposes as education, the arts, etc. It is very similar to a private express trust (requiring trust property, a trustee, a beneficiary, manifestation of intent, creation, and lawful purpose), but has two significant differences: first, the beneficiaries must be unascertainable, ie, a large class,

because the "real" beneficiary is considered the public. Second, cy pres only applies to charitable trusts, not to private express trusts. Note also that the Rule Against Perpetuities does not apply to a charitable trust either.

Here, the trust created is not a charitable trust for several reasons.

First, there was no general charitable intent. Nothing in the trust was to benefit education, etc. This lack of charitable intent is shown by the fact that the beneficiaries are not a large class. Rather, the beneficiary is one person. Therefore, this is too ascertainable to be a charitable trust.

Because this is not a charitable trust, the doctrine of cy pres will NOT apply because the doctrine does not apply to private express trusts. F will not get to share in the estate.

Trust Fails For Lack of Beneficiary

This trust will now fail for lack of a beneficiary. F does not meet the terms of the trust, and neither does anyone else. Therefore, there is no beneficiary. When a trust fails for lack of beneficiary, a resulting trust in favor of the settlor or settlor's heirs occurs. A resulting trust is an implied in fact trust based on the presumed intent of the parties. Therefore, the 5% of the estate will result back to H's heirs- which is only W under the will. W therefore, will end up taking H's entire estate under the fact pattern presented in this question.

THURSDAY MORNING
JULY 29, 2004

California Bar Examination

Answer all three questions.
Time allotted: three hours

Your answer should demonstrate your ability to analyze the facts in question, to tell the difference between material and immaterial facts, and to discern the points of law and fact upon which the case turns. Your answer should show that you know and understand the pertinent principles and theories of law, their qualifications and limitations, and their relationships to each other.

Your answer should evidence your ability to apply law to the given facts and to reason in a logical, lawyer-like manner from the premises you adopt to a sound conclusion. Do not merely show that you remember legal principles. Instead, try to demonstrate your proficiency in using and applying them.

If your answer contains only a statement of your conclusions, you will receive little credit. State fully the reasons that support your conclusions, and discuss all points thoroughly.

Your answer should be complete, but you should not volunteer information or discuss legal doctrines which are not pertinent to the solution of the problem.

Unless a question expressly asks you to use California law, you should answer according to legal theories and principles of general application.

ESSAY QUESTIONS AND SELECTED ANSWERS

FEBRUARY 2005 CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the February 2005 California Bar Examination and two selected answers to each question.

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Question 6

In 2003, Sam executed a valid testamentary trust, naming Tom as trustee. The terms of the trust state:

(a) All net income is to be paid to Bill, Sam's nephew, for life;
(b) Tom may invade principal for Bill in such amounts as Tom, in his sole and absolute discretion, determines;
(c) The trust terminates on Bill's death and any remaining principal is to be distributed to Alma Mater University;
(d) The interests of the beneficiaries are inalienable and not subject to the claims of creditors.

In 2004, Sam died.

In 2005, Lender obtained a judgment against Bill for an unpaid credit card bill that includes charges for tuition, groceries, and stereo equipment. Lender now requests a court order directing Tom to pay all future installments of trust income to it rather than Bill until the judgment is satisfied.

Bill is delinquent in making child support payments to Kate, his former spouse, for their child. Kate now requests a court order directing Tom to pay all future installments of trust income to her rather than Bill until the arrearages are eliminated.

Bill wants Tom to invade the trust principal so Bill can promote a newly-formed rock band, but Tom has refused. Bill now requests a court order directing Tom to invade the trust principal.

Because of Tom's refusal to invade the trust principal, and because Alma Mater is concerned over Bill's debt difficulties, Bill and Alma Mater wish to terminate the trust in order to divide the trust principal, but Tom has refused. Both Bill and Alma Mater now request a court order terminating the trust.

How should the court rule on the requests made by Lender, Kate, Bill, and Alma Mater? Discuss.

Answer A to Question 6

A trustee is a fiduciary relationship with respect to property where a settlor transfers property to a trustee who holds the property for the benefit of named beneficiaries, for a valid trust purpose. On the facts, Sam executed a valid express testamentary trust naming Tom as the trustee and Sam and Alma Mater University as beneficiaries. Sam has a life interest in the trust and Alma Mater has a remainder interest.

① Request by Lender

The express trust created creates a spendthrift clause under (d). As a general rule, a beneficiary's interest is both voluntarily and involuntarily alienable as a property right. Involuntary alienation allows a creditor to attach to the beneficiary's rights to future payments by obtaining a judgment.

A spendthrift clause is designed to protect the beneficiary from their spendthrift ways by prohibiting both voluntary and involuntary alienation of the beneficiary's right to future payments. Thus the spendthrift clause created in (d) prohibits Lender from attaching to Bill's future payments of income. The provision explicitly state's [sic] that the beneficiaries' interest is inalienable and not subject to creditor's claims.

However, the courts recognize exceptions to the protection provided by spendthrift provisions including where a creditor has provided necessaries to the beneficiary. Necessaries include items such as food, clothing, shelter and medical care.

On the facts, Lender provided Bill with tuition[,] groceries[,] and stereo equipment. A court would likely find that only the groceries were necessaries and would order that Lender be entitled to payment for the groceries from the income of the trust. Thus a court would likely grant Lender's requested order for payment of Bill's grocery debt.

With respect to the stereo and tuition, Lender could seek recovery based on surplus. The concept of surplus is recognized in some jurisdictions and allows a creditor to attach to future payments to the beneficiary despite a spendthrift clause where the income to be paid exceeds the beneficiaries[‘] station in life, thus resulting in a surplus. On the facts it is unclear what income is produced in relation to Bill's station in life. In making the determination as to whether surplus exists the court will only consider Bill's reasonable expenses. If Lender can establish surplus, a court would likely grant his requested order and direct Tom as trustee to pay future installments of surplus to Lender to satisfy Bill's debt.

② <u>Request by Kate:</u> Preferred Creditor

In addition to the two exceptions noted in relation to Lender, the courts have also recognized an exception for preferred creditors.

A court will disregard a spendthrift clause and allow a preferred creditor to attach to the beneficiary's future income payments from the trust. Preferred creditors include government debt and outstanding child and spousal support and alimony payments.

On the facts, the beneficiary Bill has failed to make child support payments to his former spouse Kate for the support of his child. Thus Kate is a preferred creditor and is entitled to attach to Bill's right to future income from the trust to satisfy the delinquent child support.

Therefore, a court would likely grant Kate's request and order Tom to pay trust income to Kate in satisfaction of Bill's outstanding child support obligation until the arrearages are eliminated.

③ Request by Bill - Discretionary Trust Provision

Under the terms of the will, Tom has sole and absolute discretion to determine whether or not to invade the trust principle [sic] for Bill's benefit. Tom as trustee has all express powers as set out in the trust and all implied powers required to exercise the express powers. As a fiduciary, Tom has an obligation to exercise his discretion in good faith. On the facts, there is no indication that Tom's refusal to invade the trust principal to allow Bill to promote the rock band was made in bad faith.

Therefore, based on the facts, the court would not interfere with Tom's discretion as explicitly set out in the trust and would deny Bill's request. The court would not therefore order Tom to invade the trust principal.

④ Request by Alma Mater & Bill - Termination

A court will not order a termination of a trust even with the consent of all beneficiaries where such termination would be in violation of the trust purposes and would be contrary to the testator's intent.

The trust established by Sam evidences a clear intent to provide for Bill during his lifetime. This is a valid trust purpose which continues until Bill's death. On the facts, Bill is still alive and thus the trust purpose is ongoing. As well, the termination of the trust would destroy Sam's intent to provide for Bill throughout Bill's life.

In addition, the trust has not become passive as Tom, the trustee, still has active duties in maintaining and managing the trust. Nor have circumstances changed such that the doctrine of changed circumstances would apply to modify the trust terms.

Therefore, the court would uphold Tom's refusal to terminate the trust and would deny Bill and Alma Mater's request since termination would destroy the settler/testator (Sam's) intent.

Answer B to Question 6

Trust actions are governed by the trust document.

Valid Trust

A valid inter vivos trust was created since Sam (S), the settlor, had an immediate intent to create a trust for a legal purpose, and delivered a presently existing res, title property interest, to Tom (T), the trustee, for the purposes of management for the benefit of the beneficiaries Bill (B) and Alma Mater (AM).

Type of Trust

Income

B has a life interest in the income of the trust, subject to its provisions.

Mandatory Distributions (Provision A)

The trust sets out mandatory distributions of income to B by T. T must then distribute the income to B.

Spendthrift Provision (Provision D)

All distributions, both income and principal, are subject to a spendthrift provision. This prevents creditors from attaching and beneficiaries from voluntary [sic] assigning their rights. This is held as valid restraint. B & AM may not alienate nor may creditors attach. There are, however, exceptions to the creditor[']s rule discussed below.

Principal

Discretionary to Bell (Provision B)

T is given discretionary power to distribute principal to B. T is thus not required to distribute any principal and may distribute as he feels is necessary) [sic][.]

AM (Provision C)

AM has a right to all of the principal remaining at B's death subject to the spendthrift limitation.

T's Fiduciary Duty

Trustees are subject to fiduciary duties. T is thus bound to follow the provision set out by the trust. As such, his actions below with the individuals are governed by the document provisions discu[s]sed above.

Parties[‘] Requests

Lender

As explained, as a spendthrift trust, creditors may not normally attach and T cannot be required to pay off the court order. Exceptions for creditors are made for the following creditors: government creditors, tort judgments, spousal or child support, alimony, necessities and surplus above station.

Here, Lender seeks reimbursement for groceries, a necessity. Since courts want beneficiaries to be able to obtain necessities based on credit, this exception exists and reimbursement may be made. Lender may also argue tuition is a necessity but this is likely to fail[.]

The right to collect for the stereo equipment and education may come under the surplus exception. Creditors may attach to the income a beneficiary receives beyond that which is necessary to maintain their station in life.

It is unclear here what amount B receives and what amount his past lifestyle dictates is necessary for maintenance[.] Lender may have an argument and thus gain attachment. T will then be required to make payments to Lender[.]

Kate

Again, the income to B is subject to the spendthrift provisions. Kate, however, has a claim under the exception for child support payments, since this is a creditor that courts have felt should not, in equity and public policy, be excluded. Kate may attach and require T to make payments to her. Her order ought to be granted.

Bill

Bill's order will fail. The trustee[']s fiduciary duties to the trust are governed by the document and T is granted discretion in his allocation of principal to B. T's decision not to support B's rock band plans, especially in light of B's other monetary problems, is reasonable. T appears to be using his discretion to fulfill his duty of care, acting as a reasonably prudent person managing other people's money, under the circumstances.

Further, in using his discretionary powers, T must also adhere to his duty of loyalty to all beneficiaries. While AM only has a right to the leftover, he may also consider that all parties', including B's, best interests may be served investing the principal. B's order should be denied.

Alma Mater

B&AM have both requested that the trust be terminated. A trust may be terminated where all the beneficiaries, including unborn beneficiaries represented by legal counsel, petition the court for determination. The court must also find that all of the purposes of the trust have been fulfilled.

While all the beneficiaries (present & future) are currently petitioning, B&AM, the court is likely to find that the trust's purposes have not been fulfilled. S created a trust that granted B a lifetime right in the income of the trust subject to a spendthrift clause[.]

It appears from the terms that S was attempting to insure for the provision of income to B, despite his issues with spending wisely. To prematurely cancel the trust would leave B without the protections that S intended. Cancellation would be directly at odds with this purpose.

Though it may fulfil the purpose of AM's gaining some of the principal, their express right in the trust is only to the remaining principal and not the most principal they can receive. Further, this purpose of S is best protected by T's discretionary power over the principal. B&AM's order to terminate should thus be denied.

Additionally, AM's concerns over the debts fail since B's right to the principal, AM[']s interest, is subject to T's discretion. Even if the creditors could attach under an exception, attached creditors to a discretionary interest only have a right to collect when T chooses to pay out. Only in that scenario is T required to pay the creditor. AM's interest is thus further protected and S's purposes are better furthered through the continuation of the trust and the order ought to be denied.

ESSAY QUESTIONS AND SELECTED ANSWERS
FEBRUARY 2008
CALIFORNIA BAR EXAMINATION

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Question 4

In 2001, Wilma, an elderly widow with full mental capacity, put $1,000,000 into a trust (Trust). The Trust instrument named Wilma's church (Church) as the beneficiary. Although the Trust instrument did not name a trustee, its terms recited that the trustee has broad powers of administration for the benefit of the beneficiary.

In 2002, Wilma's sister, Sis, began paying a great deal of attention to Wilma, preventing any other friends or relatives from visiting Wilma. In 2003, Wilma reluctantly executed a properly witnessed will leaving her entire estate to Sis. Following the execution of the will, Wilma and Sis began to develop a genuine fondness for each other, engaging in social events frequently and becoming close friends. In 2005 Wilma wrote a note to herself: "Am glad Sis will benefit from my estate."

In 2007, Wilma named Sis as trustee of the Trust, which was when Sis found out for the first time about the $1,000,000 in the Trust. Without telling Wilma, Sis wrote across the Trust instrument, "This Trust is revoked," signing her name as trustee.

Shortly thereafter, Wilma died, survived by her daughter, Dora, who had not spoken to Wilma for twenty years, and by Sis.

Church claims that the Trust is valid and remains in effect. Sis and Dora each claim that each is entitled to Wilma's entire estate.

1. What arguments should Church make in support of its claim, and what is the likely result? Discuss.

2. What arguments should Sis and Dora make in support of their respective claims, and what is the likely result? Discuss.

Answer question number 2 according to California law.

Answer A to Question 4

1. What arguments should Church make in support of its claim?

A. Attempted creation of the trust

A private express trust is created when the following elements are met: (1) a settlor with capacity, (2) intent on the part of the settlor to create a trust, (3) a trust res, (4) delivery of the trust res into the trust, (5) a trustee, (6) an ascertainable beneficiary, and (7) a legal trust purpose. In this case, each of these elements have been met, and Wilma successfully created a valid inter vivos express trust.

(1) The facts state that Wilma had full mental capacity.

(2) The facts indicate that a trust instrument was created, which is evidence that Wilma intended to create a trust, and not some other type of instrument or conveyance.

(3) The res here is the $1m that Wilma put in the trust.

(4) According to the facts, Wilma put the $1m into the trust, so the delivery element is satisfied.

(5) The trust instrument here did not name a trustee. However, courts will not allow an otherwise valid trust to fail for want of a trustee. Rather, courts will appoint a trustee. So, notwithstanding the lack of a trustee, the trust was validly created. In this case, the lack of a trustee was cured later by Wilma, when she named Sis as the trustee in 2007. So, at the time of Church's assertion that the trust is valid and in effect, there is a trustee and the court need not appoint one. (However, given Sis's conduct in attempting to revoke the trust, which is likely a violation of her fiduciary duty as trustee, the Church should consider moving the court to dismiss Sis as trustee and appoint a new trustee.)

(6) The beneficiary in this case is Church. Beneficiaries can be natural persons, corporations, or other organizations. So, Church is a valid beneficiary. Because the beneficiary is Church, it can argue that the trust set up by Wilma is a charitable trust. Charitable trusts have as their purpose the specific or general charitable intent to benefit some social cause. Religion is considered a legitimate purpose of a charitable trust. Thus, this trust can be considered a valid trust.

(7) There is no illegal or otherwise improper purpose for Wilma's trust, so this element is satisfied.

B. Attempted revocation of the trust

Inter vivos trusts are revocable unless otherwise provided. The facts do not state whether the trust instrument had a provision making it irrevocable, so it is assumed that the trust is revocable.

A trust cannot unilaterally be revoked by the trustee. Typically, only the settlor (if she is alive and has mental capacity) can revoke an inter vivos trust. In some circumstances, a trustee and the beneficiaries may petition the court to terminate (or modify) a trust, but no such circumstances exist here. Thus, Sis's attempt to revoke the trust unilaterally, without telling Wilma and without involving the court, by writing across the instrument "This Trust is revoked," was ineffective. The trust therefore remains in effect.

Had Wilma written across the Trust instrument "This Trust is revoked," it might have operated as a valid revocation by physical act. However, such a revocation must be done by the settlor or by someone at the direction of the settlor and in her presence, which is not what happened here.

C. Survival of the trust after Wilma's death

Sis might argue that the trust should pass to her under Wilma's will, which left her the entire estate. However, there are no facts to suggest that Wilma only intended the trust to continue for her lifetime. Rather, the creation of the charitable trust by Wilma is assumed to be a valid will substitute, which disposes of the settlor's property outside of probate.

2. What arguments should Sis and Dora make in support of their respective claims?

A. Sis's Arguments

For Sis to succeed in arguing that she is entitled to Wilma's estate under the terms of her will, she must establish that the will is valid. A valid will requires (1) a testator with capacity, (2) testamentary intent, and (3) valid compliance with the applicable formalities.

(1) Capacity: To have sufficient capacity to execute a will, a testator must (1) know the nature and extent of her property, (2) understand the natural objects of her bounty (i.e., her relatives and friends), and (3) understand that she is making a will. The facts here state that in 2001 Wilma had full mental capacity. In 2003, when Wilma executed the will, it is presumed that she still had such capacity.

(2) Testamentary intent: Here, the facts state that Wilma executed a will, although she did so "reluctantly." Mere reluctance on the art of a testator is insufficient to defeat the existence of testamentary intent. However, if the

testator's intent was the product of undue influence, then true testamentary intent will not be found, and the will will be set aside to the extent of the undue influence. In this case, Dora will argue that Sis cannot take Wilma's estate under the will because she exerted undue influence on Wilma.

Undue Influence:

Undue influence exists when the testator was influenced to such a degree that her free will was subjugated. A prima facie case of undue influence is established by showing the following: (1) the testator had some sort of weakness (e.g., physical, mental, or financial) that made her susceptible to influence, (2) the person alleged to have exerted the influence had access to the testator and an opportunity to exert the influence, (3) there was active participation by the influencing person in the devise (the act by the person that gets them the gift), and (4) an unnatural result (i.e., a gift in the will that is not expected).

(1) In this case, there is no evidence that Wilma suffered from any particular weakness that made her susceptible to Sis's influence. She had capacity. She presumably was in good physical health, as she attended social events frequently. And she presumably was of comfortable means, as she was able to give away $1m to a charitable trust.

(2) Here, Sis did have access and opportunity to influence Wilma. She began "paying a great deal of attention" to her, and she prevented any other friends or relatives from visiting her. This element of the prima facie case is therefore established.

(3) It is unclear from the facts whether Sis actively participated in Wilma's drafting of her will, or somehow suggested in some other way that Wilma leave her estate to her. Dora would need to present evidence on this point to succeed in challenging the will on the basis of undue influence.

(4) The result here is not unnatural. Wilma is survived only by Sis and her daughter Dora. However, Wilma had not spoken to Dora for twenty years. Wilma is a widow, and leaves no surviving spouse or domestic partner. The facts do not suggest that Wilma had any close non-relative friends to whom she might naturally leave part of her estate. Wilma had already provided generously for Church in the trust. Therefore, it is natural that she would leave her estate to her sister. Moreover, Sis can argue that the "naturalness" of the result is further proven by the fact that she and Wilma genuinely became close friends in the years following the execution of the will. This friendship is evidenced by the note that Wilma wrote in 2005, which stated that she was "glad Sis will benefit from my estate."

(3) Formalities: In this case, the facts state that Wilma "executed a properly witnessed will," so the last element is satisfied.

Because all of the elements of a valid will are present, and because it is not likely that Dora can prove that the gift to Sis of Wilma's entire estate was the product of undue influence, Sis will take Wilma's entire estate under the will.

B. Dora's arguments

1. Dora's rights if undue influence is found

If Dora can prove that the gift to Sis is the product of undue influence, the will will be set aside to the extent of that undue influence. If there is a residuary clause in the will, the gift to Sis will pass into it. If there is no residuary clause, then the gift to Sis – which in this case is the entire estate – will pass as if Wilma died intestate. Because Dora is Wilma's only other surviving relative, the estate would pass to her.

2. Dora's rights as an omitted child

In California, if a child is pretermitted, she has certain rights to take from her parent's estate. A pretermitted child is one who is born after a will and all other testamentary instruments have been executed, and who is not provided for in the instruments. In this case, however, Dora was already born when Wilma executed her will in 2003 and the Trust in 2001. So, Dora is not pretermitted. (Had she been pretermitted, Dora would have been entitled to claim her statutory share of the estate passing through the will, plus a statutory share of any revocable inter vivos trusts.)

California does not provide protection for omitted children. An omitted child is one who was born at the time a testamentary instrument is drafted, but not provided for in the instrument. Therefore, Dora does not have any rights to Wilma's estate by mere virtue of being omitted from Wilma's will.

Answer B to Question 4

1. Arguments Church should make in support of its claim

Whether a valid trust was formed

A trust is a fiduciary relationship relative to property, where a trustee holds legal title to such property (corpus) for the benefit of a beneficiary, and which arises from the settlor's manifested present intention to create such a trust for a valid legal purpose. In the case of a private express trust, the beneficiary must be an ascertainable person or group, while for a charitable trust the beneficiary must be society at large.

Corpus

The corpus of a trust must be a valid currently existing type of property, and may not be a mere expectancy [of] future profits or any other illusory property. In the case of a trust set up during the settlor's lifetime (inter vivos), a trust with a third person as a trustee will be under transfer in trust, with delivery of the property being actual, symbolic (some item representing ownership) or constructive (presenting the means to access the property, or, modernly, doing everything reasonably possible to put the trustee in possession, without raising suspicion of fraud or mistake).

In this case, the corpus existed and was validly delivered, because it was $1 million in money, which Wilma actually put into the trust.

Beneficiary

If the beneficiary is an ascertainable group or person, a private express trust may form. If an unascertainable group that is for the benefit of society in general, even if some individuals incidentally benefit, that is a charitable trust. For a charitable trust, the rule against perpetuities does not apply to invalidate the trust.

In this case, it could be argued that the church is an ascertainable, definite legal person, in which case Wilma may have formed a private express trust. It could alternatively be said that the real benefit is in the present and future members of the church, which advances a social interest in having religious institutions. In that case, it could be a charitable trust, and even though under the trust some people might take a benefit more than 21 years after a present life [is] in being, there is no rule against [a] perpetuities problem and the trust is valid. Therefore, there was a valid beneficiary.

Trustee

A trustee, who is appointed to administer the trust, is necessary for a trust; however, a trust instrument will not fail because a trustee is not named. In this case, even though Wilma never named a trustee, a court can appoint a trustee to fulfill the duties of a trustee, and the trust is not invalidated.

Resulting trust

A resulting trust is an implied in fact trust that occurs when a private express trust or charitable [trust] fails by means other than wrongdoing by the settlor. Under a resulting trust, the court-appointed resulting trustee's sole duty would be to convey the corpus back to the settlor or, if dead, her estate.

It might be argued against the church that Wilma created the trust in 2001, and did not appoint a trustee until 2007, that presumably the trust had no trustee for a full six years, during which there was no trustee. Therefore, it may be argued that during that time, the trust should have turned into a resulting trust. It might also be argued that in certain states, there is a statute of uses that creates a resulting trust when there is a passive trust of real estate property where the trustee has no active duties. It might [be] argued that, equitably, this principle should also apply to where the corpus is money, and that having no trustee for six years is equivalent to having a passive trustee, and that the money should have gone into a resulting trust.

However, because courts have explicitly stated that trusts do not fail for want of a trustee, the trust by Wilma will likely not fail.

Manifestation of intent

For there to be a valid trust, the settlor must have made a clear manifestation that she was delivering the property with the present intention of creating a trust. In this case, Wilma clearly showed her intent to do so. While she failed to name a trustee, she provided for there to be a trustee by naming his broad powers, and actually delivered the money into the trust. Finally, because Wilma, although elderly, had full mental capacity, there is no questioning that her ability to intend to create a trust was compromised. Therefore, Wilma clearly showed a showing of intent to create the trust, and it will be valid.

Legal purpose

Any purpose that is not illegal is allowed. In this case, Wilma clearly intended that the church and/or its members benefit in carrying out its activities on an ongoing basis, and there was nothing illegal about that. Therefore, she had a valid legal purpose.

Therefore, a valid trust was formed in 2001.

Termination of the trust

A trust may terminate by its own express terms. It may also terminate by the settlor's express revocation, where she has reserved the right to do so (in a majority of states). Finally, a trust may terminate by initiation of the beneficiaries, if all of them join and consent (any unborn remaindermen must be represented by an appointed guardian ad litem). If the settlor also joins in, the termination may proceed. If the settlor does not or has died, then the beneficiaries may only terminate if all material purposes of the trust have been fulfilled.

Revocation by express terms
Here, there is no indication that Wilma provided for the trust to have ended at any point. Therefore, it was not revoked.

Revocation by settlor
Here, Wilma did not expressly reserve her right to revoke. Even in the minority of states where the right is implied, she never exercised such right. Sis may argue that Wilma's later making a note that she was glad that Sis would benefit worked to impliedly revoke the trust, since it showed an intent that Sis benefit from her estate, this will likely not be able to show Wilma's intent to revoke. Therefore, she did not revoke the trust.

Revocation by beneficiaries
As shown above, Wilma did not consent or join in any acts to terminate the trust. Furthermore, under the facts neither the church nor its members did anything to suggest that it wanted to revoke the trust; to the contrary, the church is suing to show the validity of the trust. Therefore, the beneficiaries did not revoke.

Therefore, no revocation occurred.

Powers of the trustee
A trustee has the powers expressly granted her in the trust instrument, plus any implied powers necessary to carry out her duties, such as the powers to sell, lease, incur debts on property, and modernly, to borrow.

Here, as of 2007 Sis was named trustee of the trust. The trust instrument provided that the trustee had "broad powers" to administer the trust for the benefit of the beneficiary. It spoke nothing of trustee's power or authorization to evoke, which is not traditionally a power implied to the trustee. Therefore, Sis had no power to revoke the trust by canceling it. Therefore, it was not revoked by her acts.

Duties of trustee
Furthermore, a trustee has duties of care and loyalty to the beneficiary. Under the respective duties, she must act as a reasonably prudent person handling her own affairs, and in the best interests of the beneficiaries at all times.

When Sis attempted to revoke the trust, intending to cut out the beneficiaries, this was expressly against the trust, and breached her duty of care. Also, because she was the taker under Wilma's will, she also breached her duty of loyalty because her act would have benefited her.

Therefore, Sis acted improperly, and her act of revocation was not valid.

Conclusion
Therefore, the trust was valid and was not revoked, and the church has a claim to it.

2. Arguments Sis and Dora should make in support of their claims

Dora's arguments
I: capacity
II: insane delusion
III: undue influence
IV: pretermitted

Capacity
A testator has capacity to make a will if she is over 18, can understand extent of her property, knows the natural objects of her bounty (family members, etc.) and knows that she is executing a will. If a testator lacks capacity, the entire will will not be probated and the property passes through intestacy unless there is a former valid will.

Dora may argue that because Wilma was elderly and a lonely widow, she lacked the true capacity to make a will, and that as Wilma's sole issue, she should take the whole estate under intestacy. However, Wilma was over 18. She was of full mental capacity, and knew what her property consisted of. She knew who the natural objects of her bounty were, because presumably she knew of Sis and Wilma. And finally, she executed a properly witnessed will with no signs that she did not know what she was doing. Therefore, Dora's argument will fail.

Insane delusion
A provision in a will [can] be denied probate if 1) it was based in a false belief, 2) which was the product of a sick mind, 3) there was not even a scintilla of evidence to support the belief, and 4) the belief actually affects the will (shown by the provision in question).

Here, Dora may argue that Wilma may have had some sort of sick mind causing her to believe that she would devise all her estate to Sis and leave Dora out. However, there is no evidence to support that view. Wilma's will was based in a genuine belief in and factual close relationship with Sis that had developed. There is no indication of Wilma's sick mind. Finally, no false belief affected the will. Wilma and Sis got along well, engaged in social events together, and were close friends. Therefore, Dora's argument will fail.

Undue influence
There are three bases for undue influence: prima facie case, presumption, and CA statute.

Prima facie UI

If a person has access to a testator, the testator was of a susceptible trait, the person had a disposition to induce the testator and there was an unnatural result, there will be a prima facie case of undue influence, and the relevant affected provision will not be probated.

Here, Dora can show that Sis had access (indeed, sole access to Wilma, through her own prevention of others). Dora will emphasize that Sis acted wrongfully in paying an unnatural amount of attention to Wilma suddenly, and preventing others from accessing her. However, Sis will show that her interest in Wilma was legitimate, as shown by their growing fondness for each other. However, she cannot show that Wilma was particularly susceptible in any way. She was likely lonely, but she did not have outward signs of feebleness to subjugate her testamentary intent.

Sis may have had the disposition to induce Wilma to make a will in her favor, because she was with her all the time, but it will also be hard to show that she did anything to manipulate her into making the will. Additionally, she made the will soon after Sis began paying attention to her, and it happened to leave everything to her. Dora will argue these points; however, she cannot show that Sis actually did anything to induce the will, and the two became genuine friends. Furthermore, the note from 2005 shows that Wilma was genuinely pleased to have provided for Sis. Even if Sis had exercised a disposition to coerce a will, it would be difficult to imply that she did so with an extrinsic note showing testator's intent. Therefore, Dora will have a tough time proving this element. Her best case is likely to argue that the note was not written until 2005, and in 2003, at the time of the will's execution, a disposition was exercised, which would be enough to satisfy.

Finally, giving all of her property to Sis was not an unnatural result, though Dora will claim that cutting out a child is unnatural. Wilma had not spoken to Dora in twenty years, long before Sis's interference. Therefore, it was not unnatural to cut Dora out.

Therefore, the prima facie case fails.

Presumption UI

If a person is in a certain type of close relationship with the testator (in CA, any position where the testator reposes trust in the person), and there is a disposition to cause the devise and there is an unnatural result, there will be a presumption of undue influence, and the will will not be probated.

Here, Dora can clearly show that Wilma reposed her trust in Sis, since they were close friends and Wilma even appointed her trustee over the trust to the church. However, as discussed above it will be difficult to show disposition, and more so to show an unnatural result.

Therefore, this branch of undue influence fails.

CA statutory UI

In CA, any donative transfer will be deemed invalid if made to a drafter of a testamentary instrument, of someone related to or in business with such drafter, a fiduciary of the testator who transcribed the instrument, or a care custodian. If found, the portion will not be probated, to the extent that it is above what the person would have received in intestacy.

In this case, there are no signs that Sis had a hand in drafting or transcribing a will. Dora may argue that Sis was Wilma's care custodian, since she was elderly and alone. However, no signs indicate that she was in need of care. In fact, they attended social events together in public, implying that Wilma was quite capable of taking care of herself. Therefore, there is no statutory basis for undue influence.

Fraud in the inducement

A portion of a will affected by a person's affirmative misrepresentations to the testator, the falsity of which the person knew about, and intended to induce reliance upon, will be denied probate if it was justifiably and actually relied upon by a testator in making such portion of the will. It will rather pass to the residuary of the will, if there is one, or to a co-residuary, if already in the residuary, or to intestacy. Alternately, the court may impose a constructive trust to deliver the property to the intended beneficiary of the testator, had it not been for the fraud.

In this case, there are not enough facts to determine whether Dora or any other person misrepresented any facts to Wilma, such that she would have been induced to make a will entirely leaving her property to Sis. Dora will argue that the court should imply it, since Sis was the only person with access to Wilma and there would be no way to know whether there were such misrepresentations. If there has been, the will may be refused probate, but Dora likely cannot show this.

Pretermitted child

A child born or adopted after all testamentary instruments (wills, inter vivos, revocable trusts), and not provided for in them, will be deemed to have [been] inadvertently left out, and can take a statutory share in intestacy as if the testator had no such instruments. Here, both the trust and the will were made after Dora was born. Therefore, she cannot argue this.

Conclusion

Dora does not have very solid bases to argue that she should take Wilma's estate. If she can show that Sis exercised a disposition to coerce Wilma's will, her "ratification" in 2005 with the note would not save the will, and it would be denied probate, such that Dora could take. However, because it is difficult to

time when the relationship between Wilma and Sis blossomed, Dora's arguments are likely no good.

Sis's arguments

Validly executed will

A will is valid if witnessed by two witnesses and signed in their simultaneous presence by the testator. An interested witness who would take under the will would be presumed to have exercised wrongful influence. In this case, however, we are told that the will was validly executed, and there is no indication that Sis was a witness.

Therefore, because the will was validly executed, Sis should be able to argue that she can take the entire estate. She can raise defenses to each of Dora's claims, as explained above, and should succeed on all of them.

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ESSAY QUESTIONS AND SELECTED ANSWERS
FEBRUARY 2010
CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the February 2010 California Bar Examination and two selected answers to each question.

The answers received good grades and were written by applicants who passed the examination. The answers were prepared by their authors, and were transcribed as submitted, except that minor corrections in spelling and punctuation were made for ease in reading. The answers are reproduced here with the consent of their authors.

Question 3

Hank and Wendy married, had two children, Aaron and Beth, and subsequently had their marriage dissolved.

One year after dissolution of the marriage, Hank placed all his assets in a valid revocable trust and appointed Trustee. Under the trust, Trustee was to pay all income from the trust to Hank during Hank's life. Upon Hank's death, the trust was to terminate and Trustee was to distribute the remaining assets as follows: one-half to Hank's mother, Mom, if she was then living, and the remainder to Aaron and Beth, in equal shares.

Trustee invested all assets of the trust in commercial real estate, which yielded very high income, but suffered rapidly decreasing market value.

Hank, who had never remarried, died three years after establishing the trust. At the time of his death, the trust was valued at $300,000. Subsequently, it was proved by DNA testing that Hank had another child, Carl, who had been conceived during Hank's marriage to Wendy, but was born following dissolution of the marriage. Wendy, Carl's mother, had never told Hank about Carl.

Wendy, Mom, Aaron, Beth, and Carl all claim that he or she is entitled to a portion of the trust assets.

1. At Hank's death, what claims, if any, do the trust beneficiaries have against Trustee? Discuss.

2. How should the trust assets be distributed? Discuss. Answer this question according to California law.

Answer A to Question 3

At H's Death, What Claims do the beneficiaries have against the trustee?

Duty of Care – Prudent Investing

A trustee has a duty to manage income as a reasonably prudent investor. Under old common law, this meant that each individual investment had to be relatively safe. Under the more modern standard, risky investments are permissible, as long as the portfolio as a whole has a relatively low level of risk. The trustee will not necessarily be liable for investment losses, as long as the investments had an acceptably low level risk. Here, investing all of the trust in real estates, a fairly risky investment, violated the duty of prudent investing. The portfolio as a whole would have a very high level of risk.

Duty of Care – Investment Diversification

Related to the prudent investor duty is the duty to diversify investments. T invested 100% of the trust assets in one form of investment – commercial real estate – a clear violation of the duty to diversify investments. T should have invested in a mix of stocks and bonds, and perhaps a small percentage could be in real estate.

Duty of Loyalty to Residuary Beneficiaries

When a trust is divided between an income beneficiary and a remainder beneficiary, the trustee owes a duty of loyalty to fairly protect the interests of both beneficiaries. This includes not making investment decisions solely for the benefit of the income beneficiary, and at the detriment of the remainder beneficiary. Here, T invested all the trust assets in real estate, which produces a lot of income (which would go to H, the income beneficiary) but will have very little principal left over due to rapidly decreasing market value. This violated T's duty of loyalty to the remainder beneficiaries M, A & B.

Duty of Communication

A trustee has a duty to keep the beneficiaries updated (at least yearly) as to the general status of the trust, and investment allocations. It's not clear on the facts here if T did this – T most likely did not, as the remainder beneficiaries would undoubtedly have complained earlier If they found out the trust was 100% invested in commercial real estate, solely for the income benefit of H. So T most likely breached his duty to communicate the status of the trust.

Remedies

The beneficiaries may sue Trustee personally for the loss in market value of the real estate (they may also sue for the increase in value that would have happened if T made a reasonably safe and diversified investment).

How should the trust assets be distributed?

Pretermitted Spouse

If a will (or trust) is formed before a marriage, and the spouse is omitted from the trust, it will be presumed that the omission was accidental and the spouse will be entitled to his or her intestate share. However, if divorce has occurred in the interim, it will be presumed the spouse was intentionally omitted and the spouse gets nothing. Here, H's trust was formed after marriage to W, but they had already been divorced for 1 year by the time the trust was formed, so W cannot claim to be a pretermitted spouse.

Community Property Law

Because California law applies here, W should have already received 1/2 of all community property (property acquired during marriage by the skill or labor of either spouse). So I'll assume H's trust was made only with his separate property, and the 1/2 share of CP he got upon dissolution. This means W has no rights to it unless H makes a gift to her.

Pretermitted Heir

If a will (or will substitute such as a trust) is formed before a child was born, and the child was omitted from the will, it will raise a presumption that the child was accidentally omitted, and the child will be entitled to his or her intestate share. When a child was born before the will or trust was executed, the testator did not know of the child's existence, the child will be treated as a pretermitted heir and will get the intestate share.

Here, it appears C was born before the trust was made (C was born right after dissolution and the trust wasn't made until 1 year after the dissolution). So normally C would not be a pretermitted heir; however, H had no idea C existed when H made the trust, as W never told H about C. And it's understandable H wouldn't have noticed, as the couple divorced soon after conception, so H may not have seen W much during the following year. And the child is H's child, suggested by the fact that C was conceived during marriage, and proved by DNA testing. I don't believe it matters that C was born following the dissolution of the marriage. Thus, C will be considered a pretermitted heir and will be entitled to an intestate share.

C's Intestate Share

Property is distributed intestate to the deceased person's spouse and issue, per capita, with right of representation. Per Capita means the property is distributed in equal shares at the first level of a living heir. Normally, a spouse gets 1/3 of the estate intestate if there are also living children. However, the spouse gets nothing intestate if divorce has already occurred when the settlor or testator dies. Here, divorce has already happened when H died, so W would get nothing intestate. H has three living children, so they each would be entitled to 1/3 of the $300,000. Since there are living children, Mom would not get anything. This is in California, and divorce has already occurred by the time H died, so I'll assume W's share was already taken care of by community property law. This means C's intestate share would be $100,000.

Abatement & Distribution

Abatement is the process by which money is cleared up for a new gift by reducing previously existing gifts. I believe that, unlike abatement when the estate is insolvent, abatement for a pretermitted heir is taken pro rata from both the residuary and general gifts (gifts or money or stock). Here, there is $300K in the trust. M has a general gift of 1/2, and A & B get the remainder. Thus, before C's gift, M would get $150K, and A & B would split $75K each. C's gift of $100K will take $50 K (1/3) from M, and $25K (1/3) from both A & B.

After abatement, C will end up with $100K. M will get $100 K. And A & B will get $50K.

Answer B to Question 3

What claims do the Trust beneficiaries have against Trustee?

A trustee holds title to assets for the benefit of others, beneficiaries, and as such owes them certain duties. A trustee's violation of these duties can render him personally liable to the trustees.

Breaches of the Duty to Invest

A trustee has a duty to invest the assets of a trust and to do so with ordinary care a prudent person would use in investing their own money. Many states provide lists of acceptable investments. Likewise a trustee may consult professional investors to determine what is reasonable. In any event, two specific obligations must be met: 1) the trustee must diversify, and 2) the trustee must not speculate.

In this case, the trustee did not diversify and so has violated the duty to invest because all the trust assets were invested in real estate. Similarly, a court could find that the trustee was speculating in making these investments, which is also a violation.

Breach of the duty of loyalty

Trustees owe the beneficiaries a duty of loyalty and they owe this duty to each beneficiary equally. Favoring one beneficiary over others is a violation of this duty. In this case the trustee appears to have favored H (who was a beneficiary since income went to him during his life) over the other beneficiaries by making investments which maximized income, benefiting only H, and actually resulted in harm through diminished corpus value to the other beneficiaries. Trustee is personally liable for this breach to the beneficiaries.

Breach of the duty of care

Trustees owe beneficiaries a duty of care to act as a reasonably prudent person and the failure to properly manage the trust funds as described above is also a violation of this duty.

Other

It's also possible trustee breached his duty of accounting if he was not providing the beneficiaries with regular statements of the account balance. We need additional facts but the decrease in value indicates this could be the case.

How should the trust assets be distributed?

H created an inter vivos trust which terminated at his death and provided for 2 of his children (A & B) and his mother (if she was living). This trust was created while H was single and he never remarried. Hank died intestate but his inter vivos trust will be subject to the same probate rules as a will would have been.

Does W have any right to trust assets?

W is claiming an interest in trust assets but the trust was made after dissolution to her marriage to H. Absent some evidence that community property which should have gone to W under the court's continuing jurisdiction was used to establish the trust, W has no claim to the trust.

Carl's claim

Carl is H's child and he was conceived during but born after dissolution of the marriage. He was also apparently born before the creation of the trust since the trust was created a year after dissolution of the marriage. A child who is born after all testamentary instruments have been executed (including inter vivos trusts) or not provided for in them is pretermitted and will have a claim on decedent's estate. Here, that is not the case

since Carl was born before the trust was created and would therefore normally not have a claim. However, there is an exception when it appears that the only reason the child born before the execution of testamentary instruments was not provided for is that the parent did not know of his existence. That is the case here and so Carl will be considered a pretermitted child (his having been born after the marriage was dissolved is irrelevant).

What share does a pretermitted child take?

An omitted (pretermitted child) is entitled to take an intestacy share of the decedent's estate. The rules of intestacy would first provide for the decedent's spouse and children. Here, however, H leaves no spouse (as discussed above W has no interest in the trust) and so the intestacy rules would look to H's children. Under intestacy, children would take equally so Aaron, Beth, and Carl's share would be 1/3 each of the $300,000 corpus. Thus, Carl's share as a pretermitted child is $100,000.

What do the others take from the trust?

The trust provides that Mom gets 1/2 the corpus (assuming she's still living as appears to be the case) and the A & B split the remaining 1/2. Absent Carl's claim, Mom would've gotten $150,000 and A & B would've each received $75,000. Here, however, those amounts must be abated in order to pay for Carl's share.

In abating shares to pay for the claim of a pretermitted child the other beneficiaries will have their benefit reduced in proportion to the value they receive. Here Mom got 1/2 so she will have her share reduced by 1/2 of the amount due to Carl (i.e., $50,000). A & B each got 1/4 so their amounts are each reduced by 1/4 the amount owed to Carl ($25,000 each). Thus, the final distribution will be: Mom gets $100,000, Carl gets $100,000, Aaron and Beth each get $50,000 and W takes nothing.

FEBRUARY 2010
ESSAY QUESTIONS 4, 5, AND 6

California Bar Examination

Answer all three questions.
Time allotted: three hours

Your answer should demonstrate your ability to analyze the facts in question, to tell the difference between material and immaterial facts, and to discern the points of law and fact upon which the case turns. Your answer should show that you know and understand the pertinent principles and theories of law, their qualifications and limitations, and their relationships to each other.

Your answer should evidence your ability to apply law to the given facts and to reason in a logical, lawyer-like manner from the premises you adopt to a sound conclusion. Do not merely show that you remember legal principles. Instead, try to demonstrate your proficiency in using and applying them.

If your answer contains only a statement of your conclusions, you will receive little credit. State fully the reasons that support your conclusions, and discuss all points thoroughly.

Your answer should be complete, but you should not volunteer information or discuss legal doctrines which are not pertinent to the solution of the problem.

Unless a question expressly asks you to use California law, you should answer according to legal theories and principles of general application.

ESSAY QUESTIONS AND SELECTED ANSWERS
FEBRUARY 2012
CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the February 2012 California Bar Examination and two answers to each question that were written by actual applicants who passed the examination after one read.

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Question 1

Sam, a widower, set up a valid, revocable *inter vivos* trust, naming himself as trustee, and providing that upon his death or incapacity his cousin, Tara, should be successor trustee. He did not name any additional trustee. He directed the trustee to distribute the income from the trust annually, in equal shares, to each of his three children, Ann, Beth, and Carol. He specified that, at the death of the last of the three named children, the trust was to terminate, and the remaining assets were to be distributed to his then living descendants, by representation.

When he established the trust, he also executed a valid will pouring over all his additional assets into the trust.

Two years later, Sam died. He was survived by Ann, Beth, and Carol. Within two months, Dave, age 25, began litigation to prove that he was also a child of Sam's, although Sam had never known of his existence.

For three years after Sam's death, Tara administered the trust as trustee. Because Ann had very serious medical problems and could not work, and because Beth and Carol had sufficient assets of their own, Tara distributed nearly all of the trust income to Ann and little to Beth and Carol.

After the court determined that Dave was in fact Sam's child, Dave claimed a share of the trust. Beth and Carol have filed suit against Tara, claiming breach of fiduciary duties. Tara has submitted her resignation, and Beth and Carol have sought termination of the trust so that all assets may now be distributed outright to the beneficiaries now living.

1) What interests, if any, does Dave have in the trust assets? Discuss. Answer according to California law.

2) Are Beth and Carol likely to be successful in terminating the trust? Discuss.

3) Are Beth and Carol likely to be successful in suing Tara? Discuss.

Question 1
Answer A

1) Will Substitute

Where an inter vivos trust is created, and where the settlor gives a vested future possessory interest in the trust to a grantee, it will be considered a will substitute. Where the settlor has included a clause whereby all of the settlor's assets at the time of his death pour in to the trust for the benefit of the beneficiaries a pourover will is created. The Will requirements must be established to make this valid.

Here, Sam (S) created a valid inter vivos trust, with himself as Trustee and Tara (T) as the successor Trustee for the benefit of his three children Ann (A), Beth (B), and Carol (C). S also provided that at his death all of his other assets should be poured over into the trust for the benefit of A, B, and C.

Therefore, a valid pourover will was created, with each A, B, and C receiving equal shares of all of the assets.

Dave's (D) right as an omitted child

In general, a child may be disinherited if the child is left out of a will or other testamentary document created by a parent. However, where a child is unknown to the parent at the time the testamentary document is created, and the parent had no reason to know of the child, that unknown child will not be disinherited, and will be able to recover his intestate share of the parent's estate. A child's intestate share in a modern per stirpes system, which is the majority view taken, will be an equal share split at the first level of inheritance, in this case among the children.

Here Sam (S) set up the trust only 2 years ago. D was 25 years old at the time of S's death. Because S was born before the execution of the trust and pourover will, he would generally be treated as disinherited and unable to recover. Here, however, S

was unaware that D was alive or that D was his child at the time the testamentary documents were created. D would be considered an omitted child and have a right to his intestate share. Because A, B, and C were all alive, D would be entitled to 1/4 of S's estate. Because the trust contained all of the assets of S due to the pourover will, this will be where the assets are taken from. Notwithstanding the clause in the trust that requires the assets to be distributed to living descendants, by representation after A, B, and C die, D will not be required to wait for A, B, and C to die before recovering.

Therefore, D will be entitled as an omitted child to 1/4 of the Trust assets.

2) Termination by B and C

The power of termination depends on whether or not a trust is revocable or irrevocable. An irrevocable trust is created where the intent of the settlor is to make it as such. Here S expressly stated that the trust is to last until the death of the last of the three named children. The majority view is to find in favor of irrevocable trust, so it is likely that this language will be sufficient to establish an irrevocable trust.

Therefore, an irrevocable trust has been established, and the rules of termination, discussed below, will regard such.

Termination of irrevocable trust

Termination of an irrevocable trust can be done, either when the settlor and all of the beneficiaries agree while the settlor is still alive, or if all of the beneficiaries agree and it will not frustrate the purpose of the trust, or a merger where the trustee has become the sole beneficiary. An irrevocable trust is created when the express language of the settlor states as such.

Here, although T has not acted according to the will, and has distributed nearly all of the trust income to A and little to B and C, there must still be a mutual agreement between the beneficiaries to terminate that doesn't frustrate the purpose of the trust. The trust

specifically stated that the trust was to be terminated only at the death of the last of the three named children. Just because B and C are unhappy with the way the trust is being distributed does not give them the right to terminate the trust, either without the consent of A, or in the face of clearly stated terms of the trust made by the settlor.

Therefore, B and C will likely not be successful in terminating the trust, but as discussed below may have damages due from T.

3) Type of trust established

To a certain extent a trustee's ability to use discretion varies depending on the type of trust that is established. The greatest deference is given to the trustee in two situations, either a support trust or a discretionary trust. Both of these types of trusts, generally, must expressly state that this is the type of trust being established. The purpose of the trust, which is a necessary requirement of a valid trust should determine what type of trust is created.

Here, the T was instructed to distribute in equal shares annually. There was no express statement of purpose that the trust was being set up for distributions based on the discretion of T, nor based on the need for support of A, B, and C. One of these things would have to be established in order to create a special kind of trust that would give T additional discretionary power.

Therefore, the trust is an express trust, neither discretionary nor support, and T will be bound to the fiduciary duties of a trustee discussed below.

Fiduciary duties of trustee breached by T.

A trustee has a number of duties to the beneficiaries of the trust. Among those duties are a) a duty of care, b) a duty to distribute benefits in accordance with the trust, c) a duty to treat beneficiaries equally, d) and a duty to follow the settlor's instructions. Only in certain circumstances is the trustee allowed to use discretion in how to distribute the

income of the trust, namely a discretionary trust or a support trust. The trust duties to the beneficiary are triggered by a trustee accepting their position as such. Where a trustee has breached their fiduciary duties, they may be held personally liable, and/or may be removed from their position by the court. There are additional remedies not pertinent to this case.

Here, S was the original trustee of the trust and named T as the successor trustee. T either expressly, or at the least by conduct, accepted the position as trustee, and therefore was bound by the duties of a trustee to the beneficiaries of the trust.

Therefore, T owed the duties discussed below to A, B, and C, and any breach of such could result in personal liability and/or expulsion from the trustee position.

a) Duty of care

A trustee has the duty to act as a reasonably prudent person in her dealings as trustee. This includes investing reasonably, making reasonable distribution, and all other activities that a trustee conducts in her role as trustee.

Here, T was distributing nearly all of the trust income to A and very little to B and C. A, however, had a very serious medical problem and could not work, while B and C had sufficient assets of their own. The trust however expressly stated that distribution of the income from the trust annually should be in equal shares to each of A, B, and C.

Notwithstanding the express direction given to T as to distribution it is possible that T may have reasoned that S was not aware nor could he foresee the circumstances of A, B, and C and his real purpose was to ensure that the children were taken care of during their lives.

Therefore, T may have been reasonable in her actions as trustee, but it may be a close call because of the express direction given in the trust. T would likely have to use extrinsic evidence to show that she was acting in accordance with S's real purpose.

b) Duty to distribute in accordance with the trust

A trustee has a duty to distribute in accordance with directions given in the trust instrument. This duty is breached when the trustee acts in a way inconsistent with the specific instruction set forth by the settlor.

Here the trust expressly stated to distribute the trust in equal shares annually to A, B, and C. T, however, decided unilaterally to distribute the majority of the trust income to A and very little to B and C. This was clearly inconsistent with the directions given by S in the trust instrument.

Therefore, T breached her duty to act in accordance with the trust, and will be liable to B and C for the difference between what they were distributed and what they were entitled to under the trust.

c) Duty to treat beneficiaries equal

A trustee should give the same care and deference to each beneficiary of the trust, in accordance with the trust purpose.

Here, T gave sympathy to A because of her medical condition, and was less concerned with B and C because they had "sufficient assets of their own." It is not a fair and equal treatment to penalize a beneficiary because they have assets available to them outside of the trust. To hold that such action by a trustee is allowed, would be to disgorge the settlor of the trust of his ability to leave trust assets to whomever he might choose. A trust is not only set up for individuals who are in need (as discussed above this is not a support trust), but rather for the benefit of whomever the settlor feels he would like to distribute benefit to.

Therefore, T has not treated B and C the same as A and will be liable for a breach of duty, again with the remedies as described above.

d) Duty to follow settlor's instructions

A trustee has a duty to follow the instructions given to him be the settlor.

Here, the instruction was to distribute the shares equally to A, B, and C. T did not, as discussed above, do so.

Therefore, T breached his duty to follow instructions of the settlor.

Question 1
Answer B

1) Dave's Interest in the Trust Assets

Pretermitted Children

Dave was not specifically provided for in the trust instrument set up by Sam. This is because the trust only mentioned Ann, Beth, and Carol. As such, Dave would normally not have any interests in the trust. However, a pretermitted child may be entitled to a stake in the trust if he can show that he is a pretermitted child. A pretermitted child is one who is born or discovered after the execution of a will. In this case, Dave was presumably not born after the execution of the trust and will as he was 25 years old at the time of Sam's death, and Sam executed the trust and will only two years before his death. However, [he] had never known of Dave's existence. Therefore, Dave is a pretermitted child of Sam's, and may be entitled to some of Sam's estate.

A pretermitted child is entitled to what would be his intestacy's share of the deceased's estate. A pretermitted will not be entitled to this share of the estate, however, if the deceased specifically excluded all children from his will, and the intent to do so is shown on the face of the document. That is not the case here, though, as Sam created the trust to distribute income to his three children that he knew about. Additionally, a pretermitted child will not be entitled to any interest in the estate if the deceased provides for the child in another manner, such as an inter vivos trust, that is intended to take the place of the child's intestatacy share. Again, this did not happen here because the inter vivos trust did not provide for Dave. Therefore, because Dave is a pretermitted child, and because none of the exceptions apply that would exclude him from having an interest in the deceased's estate, he is entitled to receive what would have been his intestate share of the estate.

Dave's intestate share of the estate would be equal to 25% of the estate. This is because when Sam died, he had four children and was a widower. Also, there is no mention that Sam had any living siblings or parents. All four of Sam's children survived him, and therefore if Sam had died intestate, each child would receive his share based on a per capita calculation. Therefore, each of Sam's four children would be entitled to 25% of his estate if he had died intestate. The calculation of what Dave is entitled to receive will include the value of the trust. This is because the estate is considered to include assets held by the deceased in a revocable inter vivos trust. Here, the trust that Sam created was revocable and inter vivos declaration in trust. Dave will be able to receive his interest in the estate by abating what was given to the other children. This abatement will occur by operation of law, and would mean that Ann, Beth, and Carol would each have their interest reduced from 1/3 of the estate to 25%.

2) Termination of the Trust

There are several manners in which a trust can be terminated. A trust will be terminated when a specific condition in the writing calls for the termination of the trust and is satisfied. In this case, the trust stated that it would terminate at the death of the last of the three named children. Here, all three of the named children are still alive, and therefore the trust will not terminate.

Further, a trust can be terminated when the stated purpose of the trust has been satisfied and all beneficiaries and trustees agree to end the trust. In this case, this option does not appear to be available. Although there was no stated purpose to the trust, it provided for equal payments to each of Sam's children. Therefore, the purpose of the trust appears to be to provide for Sam's children as long as they are living. This purpose is not satisfied as all three children are still living, and can still be provided for. Also, it is not clear that all the beneficiaries would agree to terminate the trust. Only Beth and Carol are suing to terminate the trust, and there is no indication that Ann or Dave would agree to the termination.

In addition, a trust may also be terminated when all beneficiaries agree to terminate the trust. As stated above, it is not clear that all beneficiaries would agree to terminate the trust because there is no indication that Ann or Dave would agree. Also, the trust has further beneficiaries besides the three named children. The trust provides that after the death of the last of the three named children, the remaining assets of the trust were to be distributed to Sam's then living descendants. This is a vested remainder subject to an open class. The class is vested because it is not subject to any conditions precedent, and it is created in an ascertainable group of people (Sam's living descendants). The interest does not violate the rule against perpetuities, which states that for an interest to be valid, it must vest within 21 years of some life in being at the creation of the interest. Here, the interest will vest when the last of the three named children dies. Therefore the interest must and will vest within 21 years of a life in being at the creation of the interest. Because this class has an interest in the trust, they are beneficiaries of the trust. If the trust is to be terminated due to consent of all the beneficiaries of the trust, they must also consent. There is nothing to indicate that they would consent to the termination of the trust, and therefore Beth and Carol will not be successful in terminating the trust.

Beth and Carol may additionally claim that the trust should be terminated because Tara, the sole trustee, resigned from her position, and because the trust itself does not name any additional trustees. However, this argument will be unsuccessful. Courts will not allow a private express trust to fail for lack of trustee. Instead, a court will merely appoint a new trustee. Here, even though the trust itself does not provide for any additional trustees, the court will appoint someone else to serve as trustee rather than letting it fail.

3) Fiduciary Duties of a Trustee

Beth and Carol will likely be successful in suing Tara, as she has breached several of her duties as the trustee. A trust creates a fiduciary type relationship with respect to property that is held by the trustee for the benefit of beneficiaries. The trustee

must satisfy those fiduciary duties, and if she fails to, may be personally liable for all losses or damages that result to the trust.

Duty of Loyalty

A trustee must satisfy the duty of loyalty by acting in good faith and in the best interests of the trust and beneficiaries. A trustee must not act for her own benefit. Further, a trustee must not favor certain beneficiaries over others. Here, Tara did nothing to show that she was acting for her own benefit. However, Tara was favoring Ann over the other beneficiaries. Tara was doing this because Ann had serious medical problems and could not work, and because Beth and Carol had sufficient assets of their own. Despite her good motives for acting such, though, Tara still violated her duty of loyalty. Her actions specifically favored Ann over the other two beneficiaries. Further, her actions violated the explicit instructions that were contained in the trust and required her to distribute the income from the trust annually and in equal shares to each of the children. Therefore, Beth and Clara could successfully show that Tara breached her fiduciary duty with respect to the trust.

Duty of Care

Additionally, a trustee must satisfy a duty of care by acting in good faith as a reasonably prudent person would with respect to the trust. Here, Tara failed to follow the explicit instructions contained in the trust that required she distribute the income in equal shares to each of the children by providing nearly all the income to Ann. This failure to follow explicit instructions shows that Tara was not acting as a reasonably prudent person would act with respect to the trust. Rather, a reasonably prudent person would follow the instructions contained in the trust. Therefore, Beth and Carol could show that Tara had also breached her fiduciary duty of care.

Other Duties

It is possible that Tara violated other fiduciary duties, such as the duty to invest, the duty to provide accountings to the beneficiaries, the duty to label trust funds, and the duty to keep trust funds separate from other funds. However, the facts do not indicate that Tara breached any other fiduciary duties she had with respect to the trust.

Remedies

Having violated her fiduciary duties, Tara may be personably liable to the beneficiaries. Beth and Carol could sue Tara for damages of the amount of income that they should have been receiving under the trust. In the alternative, Beth and Carol could sue to have a constructive trust created from the excess income that Ann received over what she was entitled to receive from the trust. In such a scenario, Ann would hold the excess income as a constructive trustee, and would be required to return it to Beth and Carol.

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ESSAY QUESTIONS AND SELECTED ANSWERS

JULY 2013

CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the July 2013 California Bar Examination and two selected answers for each question.

The answers were assigned high grades and were written by applicants who passed the examination after one read. The answers were produced as submitted by the applicant, except that minor corrections in spelling and punctuation were made for ease in reading. They are reproduced here with the consent of the authors.

Question Number	Subject
1.	Professional Responsibility
2.	Constitutional Law
3.	Community Property
4.	Contracts
5.	Wills/Trusts
6.	Remedies

Question 5

In 2000, Ted was married to Wilma, with whom he had a child, Cindy. Wilma had a young son, Sam, from a prior marriage. Ted typed a document entitled "Will of Ted," then dated and signed it. Ted's will provided as follows: "I give $10,000 to my stepson. I give $10,000 to my friend, Dot. I leave my share of all my community property to my wife. I leave the residue consisting of my separate property to my daughter, Cindy. I hereby appoint Jane as executor of this will."

Ted showed his signature on the document to Jane and Dot, and said, "This is my signature on my will. Would you both be witnesses?" Jane signed her name. Dot was about to sign when her cell phone rang, alerting her to an emergency, and she left immediately. The next day, Ted saw Dot. He had his will with him and asked Dot to sign. She did.

In 2010, Wilma died, leaving her entire estate to Ted.

In 2011, Ted married Bertha.

In 2012, Ted wrote in his own hand, "I am married to Bertha and all references to 'my wife' in my will are to Bertha." He dated and signed the document.

Recently, Ted died with an estate of $600,000, consisting of his one-half community property share of $300,000 in the $600,000 home he owned with Bertha plus $300,000 in a separate property bank account.

What rights, if any, do Bertha, Sam, Dot, and Cindy have in Ted's estate? Discuss.

Answer according to California law.

SELECTED ANSWER A

The issue is whether Bertha, Sam, Dot, and Cindy have rights, if any, in Ted's estate. In determining this, it is first critical to consider the validity of any of the testamentary documents executed by Ted.

Ted's 2000 Will

First, it is critical to consider whether Ted's executed will in 2000 is valid. To determine this we must consider whether there is (i) testamentary capacity, (ii) testamentary intent, and (iii) formalities have been met.

Testamentary Capacity

A testator must have legal and mental capacity.

First, legal capacity requires for the testator to be above the age of 18 at the time of executing the will. Here, Ted was married and had a child; therefore, presumably Ted was over the age of 18.

Second, mental capacity requires for minimum mental capacity test to be met. That is, the testator must (i) understand the nature of his bounty (his relationships), (ii) understand the nature of his assets, and (iii) understand the nature of his actions.

First, here, Ted likely understood the nature of his relationships, given that he described in the will his stepson, friend Dot, daughter Cindy, and his wife. Second, Ted likely understood the nature of his assets given that he gives $10,000 to his stepson and friend and leaves the shares of his community property to his wife. Third, Ted likely understands the nature of his actions given that he entitled the document that he typed "Will of Ted."

In short, the minimum mental capacity test is likely met.

Further consider whether Ted suffers from an insane delusion. Under this doctrine, a testator does not have capacity if suffering from a mental defect that causes the testator to suffer from an insane delusion, and but for such a delusion the document or provision of the testamentary document would not have been produced. Here, the facts do not indicate that Ted suffered from any mental defect or insane delusion.

In short, Ted has testamentary capacity.

Testamentary Intent

A testator must have present testamentary intent, which can be inferred from the document having material provisions and appointing an executory.

Here, Ted typed a document called "Will of Ted" and he set forth provisions distributing his property as well as appointing an executor. In short, Ted has testamentary intent.

It is critical to note whether there is any fraud, undue influence, mistake, or whether the will is a conditional or sham will. The occurrence of any of these instances may negate testamentary intent. The facts here do not suggest or reflect any incidence of fraud, undue influence, mistake, or the will being a conditional or sham will.

Thus, Ted has testamentary intent in executing the document.

Formalities

A will can either be a holographic or attested will.

For an attested will to be valid it must be in writing, signed by the testator, and also signed by at least two witnesses. Note, that the two witnesses must be in the presence of the testator (presence includes sight, hearing, etc.) when the testator signs the will or acknowledges his signature on a will; the witnesses must also understand that they are signing as witnesses to a will. Note, that witnesses need not sign the will in the

presence of the testator or in the presence of each other. Witnesses need only sign the will prior to the death of the testator.

Here, Ted typed the will, dated and signed it. Next, he showed his signature on the document to Jane and Dot and said, "This is my signature on my will. Would you both be witnesses?"

Jane signed her name, and Dot was about to sign when her cell phone rang, alerting her to an emergency, and she left. However, the next day, Ted saw Dot and asked Dot to sign the will and she did.

Given the facts above, here both witnesses were in the presence of the testator when he acknowledged his signature on the will and both witnesses signed the will prior to the death of Ted.

Thus, since the will is in writing, signed by the testator as well as at least two witnesses the will is valid.

Interested Witnesses

Witnesses who sign a will and are receiving a gift under the will are interested witnesses. Signing of a will by interested witnesses does not invalidate the will. Instead, a rebuttable presumption of undue influence/fraud applies to the interested witnesses; if the witnesses are not able to rebut the presumption then the gift fails and the witnesses would only get the amount from the testator that they would be entitled to under intestate succession. Note, however, that a person in the will given a fiduciary title or executory title is not an interested witness.

Here, Jane and Dot are the witnesses. Jane is appointed as the executor of the will and is, thus, not an interested witness as discussed above. Dot is a friend of Ted's and is granted $10,000 in the will and is an interested witness. As a result, the rebuttable presumption of undue influence/fraud applies to Dot. If Dot is unable to rebut the presumption, then the gift is invalidated and goes into the residue and Dot would only

take what she would receive under intestate succession, which would be nothing as Dot is only a friend of Ted and would not receive anything under intestate succession. If Dot was able to rebut the presumption then Dot will be entitled to the gift.

The facts here do not indicate whether there was any undue influence or fraud on behalf of Dot. Regardless, note that the interested witness problem may be cured by a republication by codicil (see below). If there is a valid codicil (see below), republication by codicil will apply and will cure the interested witness problem, which means that Dot will then be entitled to the $10,000.

Now that the 2000 will is valid, it is also critical to consider whether the 2012 note by Ted is a valid codicil.

2012 Note by Ted

The issue is whether the 2012 note by Ted is a valid codicil. A codicil is any writing that can accompany a will; note that an invalid codicil does not invalidate a will. Further note that a codicil must meet the same validity requirements as discussed above with respect to a will. That is, a codicil is valid if (i) testator has capacity, (ii) testator has intent, (iii) all formalities have been met.

Testamentary Capacity

See rule above.

First, regarding legal capacity, see above.

Second, regarding mental capacity, in 2012, Ted wrote “I am married to Bertha and all references to my wife in my will are to Bertha.” Such writing reflects that Ted understood the nature of his action, relationship, and assets as he refers to his will and clarifies the term “to my wife” to be Bertha, the woman he married after Wilma’s 2010 death.

In short, the facts support that Ted had testamentary capacity.

Testamentary Intent

See rule above.

Here based on the statements in the writing there appears to be testamentary intent. Furthermore, the facts do not indicate any fraud, undue influence, or mistake.

Formalities

A holographic codicil must be in writing and signed by the testator. Note that the writing may occur on any paper or surface.

Here, Ted wrote in his own handwriting "I am married to Bertha and all references to 'my wife' in my will are to Bertha."

Given that the codicil was signed and in Ted's handwriting, the codicil is valid.

In summary, the 2000 will and the 2012 codicil are both valid.

Integration

Integration entails that all documents in physical and legal connection will be read together at the testator's death.

Here, the 2000 will and the 2012 codicil are valid and have a legal connection to one another. Therefore, both will be read together.

Distribution of Ted's Estate

Upon Ted's death, his estate consisted of his one-half community property share of $300,000 in the $600,000 home he owned with Bertha plus $300,000 in a separate

property bank account. Ted's estate should be distributed as follows.

$10,000 to Stepson

Ted's 2000 will states, "I give $10,000 to my stepson." This is a general gift; a general gift is a gift that can be satisfied by the general estate.

Here, Ted's stepson is presumably Wilma's young son Sam. Note that if there are any ambiguities in a will, the court will consider extrinsic evidence clarifying any ambiguities (whether latent or patent ambiguities). Here, the court will likely consider that Ted's prior marriage to Wilma, who had a young son Sam from a prior marriage. Therefore, even if any opposing arguments are made to contest this interpretation, it is likely that the court will find that Sam was Ted's stepson, as there is no evidence to the contrary.

Given that the 2000 will is valid and the 2012 codicil has not revoked or amended the will with respect to the general gift to the stepson, the stepson is entitled to $10,000 from the $300,000 separate property bank account.

$10,000 to Dot

As discussed above, at the time of execution of the 2000 will Dot was an interested witness. However, as discussed above, the 2012 codicil was valid and therefore republication by codicil took into effect. When republication of codicil occurs, it cures any interested witness problems; this means that the court will only consider now whether there was any interested witness at the time of the 2012 codicil instead of the 2000 will.

As a result, the republication by codicil cures any interested witness issues and Dot will be entitled to receive the $10,000 gifted to her in Ted's will. This $10,000 is a general gift for the same reasons as discussed with regards to the gift to the step-son. Thus, the $10,000 will be satisfied from the $300,000 separate property bank account.

Community Property to "My Wife"

Here, the 2000 will devises all of Ted's "community property to his wife." Furthermore, in the 2012 codicil Ted wrote "I am married to Bertha and all references to my wife in my will are to Bertha."

Note that the court will likely consider the 2012 reference of "my will" as an act of incorporation by reference. A testator may incorporate by reference any document so long as that document is existing and it is described sufficiently and the testator so intends. Here, by referring to his "will" Ted is incorporating his will by reference. Since the will existed at the time of the codicil and the codicil was specific in referencing the will, the court will likely presume that Ted intended to incorporate the will.

Furthermore, as discussed above, the court will consider extrinsic evidence if there is any ambiguity in any testamentary document. Thus, the court will consider the codicil as well as the fact that in 2011 Ted married Bertha after Wilma had died in 2010.

In short, whether by incorporation by reference or by considering extrinsic evidence, the court will find that the statement "to my wife" is intended to identify "Bertha."

As a result, the codicil and the will together, Bertha is entitled to Ted's one-half community property share of $300,000 in the $600,000 home Ted owned with Bertha.

Residual Estate to Cindy

A residual gift is a gift of anything remaining after the distribution of the estate.

Here, Ted's 2000 will states "I leave my residue consisting of my separate property to my daughter Cindy."

As this is a residual gift, Cindy gets whatever remains in the residual estate. That is, after deducting the $20,000 paid to Sam and Dot, Cindy, Ted's daughter, is entitled to $280,000 of the separate property bank account.

In conclusion, Bertha, Sam, Dot and Cindy have rights in Ted’s estate as described above.

SELECTED ANSWER B

For convenience: Ted = T, Wilma = W, Sam = S, Dot = D, Jane = J, Bertha = B

a. Is T's 2000 Will Valid?

The rights of the respective parties will depend on whether T's 2000 will is valid.

Capacity

In order to make a valid will, a testator must have the capacity to do so. A testator has capacity when he is over the age of 18, understands the nature and extent of his property, understands the natural objects of his bounty (his relationships), and understands the nature of the testamentary act.

Here, T is married, and is thus presumably over 18. Additionally, he drew up a document purporting to be his will, entitling it "Will of Ted," and made dispositions of his property, mentioning cash and community property. He left gifts to his friend, his stepson, his wife and his daughter. Therefore, it can be said that he knew the extent of his property, his relations with others, and the nature of the testamentary act. Therefore, T had capacity to make this will.

Present Testamentary Intent

A testator must also have the present intent to make the will effective upon his death. Here, because of the reasons above, and the fact that he had Dot and Jane sign it as witnesses, likely satisfies T's intent to make this will effective. Therefore, present testamentary intent is satisfied.

Attested Will Validity

An attested will is a witnessed will. In order to be valid, the will needs to be in a writing, signed by the testator, the signature was either done in the joint presence of 2+ witnesses or acknowledged in the joint presence of those witnesses, the witnesses both sign during the testator's lifetime, and the witnesses understand that they are witnessing a will.

Here, T drafted an instrument purporting to be his will, dated and signed it. Additionally, he approached Jane and Dot, while they were both together, and said "This is my signature on my will. Would you both be witnesses?" Therefore, he acknowledged his signature on his will written within the joint presence of 2+ witnesses.

However, after he acknowledged the signature, only Jane signed immediately. Dot did not sign until the next day. However, for attested wills the witnesses do not need to both be present when one another sign; they just both need to be present when T acknowledges his will. Therefore, this requirement was satisfied, and Dot validly signed it as a witness the next day.

Because both witnesses signed in T's lifetime, both witnesses were present when T acknowledged his signature, and they both understood they were witnessing his will by T's statement and identification of the instrument.

Therefore, this was a valid attested will.

Interested Witness Problem

A witness is deemed to be interested if they are a witness to the will and also take under the will. However, this does not affect the validity of the will for lack of witnesses but has an impact on the interested witnesses' gift. Therefore, even though D takes under the will, she can still be a witness. Her gift will be discussed below.

Additionally, while J is also a witness and named in the will, she is not an interested witness since she is only named in an executor capacity.

Holographic Will

A will can be valid as a holographic will if all material terms are in the testator's handwriting, and the testator signs the will. All material terms refer to the naming of gifts and beneficiaries. Here, this writing was all typed and not in T's own handwriting. Therefore, this would not be a valid holographic will.

Terms of Will

Since the 2000 will is valid, the disposition of T's estate will be pursuant to it unless it is otherwise altered or revoked. The terms are as follows:

$10,000 to his stepson

$10,000 to D

All of my share in community property to T's "wife"

Residue to J.

b. Rights of Bertha

Under the will, all of T's interest in community property was to go to "his wife." T has $300,000 of a community property interest in the house he owned with Bertha. Bertha will argue that this allows her to take his share of the community property for two reasons:

Is the reference to "my wife" an act of independent significance

A will can allow the completion of a gift to be made based on an event to be happening in the future. This is called an act of independent significance. The requirements for a valid act of independent significance are that the event has an independent significance outside of the wills making process.

Here, T stated that his share of community property would go to "his wife." Therefore, this gift is conditional on T having a wife at his death. Because marriage is separately significant from the wills making process, this is a valid gift conditioned on an act of independent significance, and will allow B to take the $300,000 community property interest.

Valid Codicil

A codicil is an instrument that amends, alters, or revokes a will. In order for it to be valid, it needs to comply with the formalities required for wills.

Here, B will argue that T's 2012 handwritten note that identifies B as T's wife under the 2000 will is a valid codicil allowing her to take the community property share in the house. Thus, the validity of this instrument depends on its compliance with formalities.

Attested Will

See the rules for attested wills above. This instrument would not qualify as an attested will because it is not witnessed. Therefore, it cannot be a valid testamentary instrument on this basis.

Holographic Will

See the rules regarding holographic wills above. Here, this was signed by T and was in his own handwriting. It describes that all references in his will are to B. Therefore, all material terms are set out, and in T's own handwriting. Therefore, this is a valid holographic codicil.

Incorporation by Reference

A testamentary instrument is allowed to refer to an instrument to complete the gifts if the instrument clearly refers to a written document, that document is in existence at the time of execution of the instrument, and it was the testator's intent for the document to be incorporated into his will.

Here, in the 2012 instrument, T clearly identified his prior will, that will was already in existence, and it was T's intent to incorporate the will into this current instrument as he uses the instrument to explain that all references are to B. Therefore, his prior will was validly incorporated to complete the gift in the 2012 instrument.

Therefore, B will take T's $300,000 community property interest in the home.

c. Rights of Sam

The 2000 will makes a gift to T's "stepson," of $10,000. However, T's stepson is not identified by the instrument.

Ambiguities

At common law, parol evidence (evidence outside of the will) was not allowed to correct a patent defect under the will. Parol evidence was only allowed to cure latent ambiguities. A will was patently defective if the identity of a beneficiary cannot be ascertained.

Here, the gift only mentions T's stepson, which would seem to be S, but since T is no longer married to Wilma from her death, and it does not appear B has any son of her own from a prior marriage, it is unclear if there is a stepson any more. Therefore, under common law, this gift would fail for lack of an identifiable beneficiary.

However, CA allows all parol evidence in to clear up any ambiguities, whether latent or patent, in order to more closely effectuate the intent of the testator.

Therefore, S will be able to introduce evidence that he was, when the 2000 will was drafted, T's stepson, and it was T's intent that the gift should go to S. This evidence will likely be properly admitted by the court to allow the gift to pass to S.

Therefore, S will likely take the $10,000.

d. Rights of D

Under the 2000 will, D will claim a gift of $10,000.

Interested Witness Problem

The issue presented is that D was a witness to the 2000 will as well as a beneficiary. If a witness to the will is also a beneficiary, there is a rebuttable presumption that the witness exercised undue influence in the drafting process. If the witness is a relative, they are still allowed to take the gift up to what their intestate share would have been; however, non-relatives, who would not have an intestate share, do not take at all.

Here, D is a non-relative since she is specifically listed as T's friend. Therefore, if she is unable to rebut the presumption, she would take nothing under the will. She can rebut this presumption by showing with clear and convincing evidence that there was no undue influence. Here, there are no facts suggesting that D procured her gift improperly: T typed up the will on his own, later executed a codicil as discussed above without validating the gift to D, and there was nothing said by D regarding her gift when T asked her to sign. Therefore, the presumption is likely rebuttable, and D can take her $10,000 gift even as an interested witness.

Republication by Codicil

When a valid codicil is executed, it updates the date of execution of the will to the date

that the codicil was executed. Here, as discussed above, T had executed a valid codicil in 2012. Thus, the will has been republished by codicil. Additionally, because it was deemed to be a re-execution of the will, any prior interested witness problems with the will are cured unless the interested witness was also a witness to the codicil who takes a new gift under the codicil.

Here, as discussed above, T executed a valid codicil in 2012, and this codicil was holographic. D did not witness this instrument, nor was she named in it. Therefore, this has been a republication which cured the interested witness problem posed by D being a witness and a beneficiary under the 2000 will.

Therefore, even if D could not rebut the presumption of undue influence, she will take her $10,000 gift because of republication by codicil.

e. Rights of C

As discussed above, S will get $10,000, D will get $10,000, and B will get T's $300,000 community property interest. Therefore, there is $280,000 left undisposed in T's estate.

The leftover of an estate that is disposed of by will is referred to as the residue. Unless there is a direction of disposition, the residue is distributed by intestate succession. However, a testator can include a residue clause which leaves the residue of his estate to an identified beneficiary.

Here, T set out that the residue of his estate was to go to his daughter C. Therefore, C is a residuary beneficiary, and thus will be able to take the $280,000 not specifically disposed of under the will.

Therefore, C gets $280,000 out of T's $300,000 separate property.

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ESSAY QUESTIONS AND SELECTED ANSWERS

JULY 2014

CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the July 2014 California Bar Examination and two selected answers for each question.

The answers were assigned high grades and were written by applicants who passed the examination after one read. The answers were produced as submitted by the applicant, except that minor corrections in spelling and punctuation were made for ease in reading. They are reproduced here with the consent of the authors.

Question Number	Subject
1.	Contracts/Remedies
2.	Evidence
3.	Business Associations / Professional Responsibility
4.	Criminal Law and Procedure
5.	Trusts / Community Property
6.	Torts

Question 5

Henry and Wynn married in 2000. During the first ten years of their marriage, Henry and Wynn lived in a non-community property state. Henry worked on writing a novel. Wynn worked as a history professor. Wynn kept all her earnings in a separate account.

Eventually, Henry gave up on the novel, and he and Wynn moved to California. Wynn then set up an irrevocable trust with the $100,000 she had saved from her earnings during the marriage. She named Sis as trustee and Henry as co-trustee. She directed that one-half the trust income was to be paid to her for life, and that the other one-half was to be paid to Charity, to be spent only for disaster relief, and that, at her death, all remaining assets were to go to Charity.

Wynn invested all assets in XYZ stock, which paid substantial dividends, but decreased in value by 10%. Charity spent all the income it received from the trust for administrative expenses, not disaster relief.

Later, Sis sold all the XYZ stock and invested the proceeds in a new house, in which she lived rent-free. The house increased in value by 20%.

Henry has sued Sis for breach of trust, and has sued Charity for return of the income it spent on administrative costs.

1. What is the likely result of Henry's suit against Sis? Discuss.

2. What is the likely result of Henry's suit against Charity? Discuss.

3. What rights, if any, does Henry have in the trust assets? Discuss. Answer according to California law.

QUESTION 5: SELECTED ANSWER A

1. Henry v. Sis

As discussed in #3, Henry does not currently have a personal interest in the trust assets. However, he is the co-trustee of the trust, and this may be sufficient to give him standing as trustee to bring an action against Sis for breach of her fiduciary duty as trustee.

Trust creation

To be valid, an express private trust must have a settlor, an ascertainable beneficiary, res, a valid purpose, and a trustee. However, the court will appoint a trustee if one is not provided for, or the elected trustee declines to serve. Here, Wynn is the settlor, and she has designated herself and Charity as lifetime beneficiaries, and Charity as the remainder beneficiary. Any natural person, entity or government can be a beneficiary of an express private trust. Both are ascertainable beneficiaries because they are either persons or entities expressly named in the trust instrument. The res can be any property or present interest. Here it is the $100,000 from Wynn's separate account. The trust appears to have two purposes: to provide lifetime income to Wynn; and to contribute to disaster relief via Charity. To be valid, a trust purpose must be able to be determined from the trust document, and must not be illegal. Neither of the purposes are illegal and are clear from the trust document. Wynn has designated Sis as trustee and Henry as co-trustee, and from the facts it does not appear that either declined to serve. They must be competent but there is no indication of incompetency in the facts.

Charitable trusts differ in that they must have a charitable purpose: something that contributes to societal good, such as abating hunger, education generally, religion, or the like. The beneficiaries of the trust must be indefinite, not a specific person. Here, because Wynn is a specific person, this could not be a charitable trust.

A valid express private trust was created.

Trustee powers

A trustee has the powers expressly granted in the trust document itself, and those implied in order to effect the purpose of the trust. Here, the trust instrument directed Sis to pay one-half of the income to Wynn, and the other half to Charity. This expressly gave her the power to make these distributions.

Trustee duties

A trustee has the duty of loyalty, to act for the benefit of the beneficiaries solely, and not in her own self-interest or that of third parties. This duty requires the trustee to be impartial as to multiple beneficiaries. Here, Sis has a duty to treat Wynn and Charity impartially. If this were a revocable trust, she would have a primary duty during Wynn's lifetime to Wynn as the settlor, but the trust is irrevocable.

As part of the duty of loyalty, a trustee has a duty not to self deal. Sis is living in the house owned by the trust, rent-free. Thus she is reaping personal benefit from her position as trustee. She has violated her duty of loyalty.

The trustee has a duty of care as well, which requires her to act as a prudent person would in handling their own affairs. This includes the duty to account regularly to the beneficiaries, and not commingle trust assets with her own.

As part of the duty of care, a trustee has a duty to invest the trust res as a reasonably prudent investor would. Under the traditional view, this limited the holdings of the trust to things such as blue chip stock, 1st trust deeds on real estate, government bonds and other conservative and safe investments. Each separate investment was considered separately in determining this. Modernly, the investments are looked at as a whole, and factors such as the need for income, tax consequences, and particular trust purposes are considered. Thus, the court will need to look at how Sis invested the trust res in light of whether the trust was intended more for lifetime income sources, or as a gift to

Charity at Wynn's death, at how the income would affect taxes, at what was reasonable as an investment in light of what was available to invest, at what reasonable investors were doing at the time.

Wynn originally invested the trust assets in XYZ stock, which provided substantial dividend income but lost value overall. This would seem to indicate a preference for lifetime income over growth of the principal.

Henry will need to be able to show that a reasonably prudent investor would not have sold the XYZ stock and invested it in a house. The sale of the stock itself may have been prudent given the loss in value. However, a trustee also has a duty to diversify in order to reduce the risk of loss and enhance income/growth opportunity, as would a reasonable investor. While the duty to diversify may have called for Sis to sell some or all of the XYZ stock, that same duty would generally preclude sinking all of the proceeds into one property. The trust res is then subject to any decline in real estate in the market, and will not benefit from any gains in other potential investments. Sis has probably violated her duty of prudent investment, and has certainly violated her duty to diversify.

The duty to make the res productive requires that Sis put the assets to work for the benefit of the beneficiaries. When she lived in the house rent-free, she violated this duty. The rental income from the house is to be distributed to Wynn and Charity, not retained for her benefit.

Sis has a duty to effect the purpose of the trust, by ensuring that income is maximized, based on the express and apparent intent of the settlor. She has not done so by selling the income stock and buying a house that currently provides no income to the trust.

Because Henry is currently subject to these same duties as co-trustee, he is obligated to prevent the wrongdoing of the other trustee. Thus he has standing to bring an action against Sis for her violations of duty, as a trustee of the trust.

Remedies available

The remedies available against a trustee who has violated their duties includes removal, surcharge for lost income/profits, disgorgement of any benefit wrongfully taken by the trustee. This benefit does not run to Henry, who is acting solely for the trust beneficiaries' benefit.

Henry will seek an accounting for the rent that should have been paid by Sis while living in the house owned by the trust. These funds must be paid personally by Sis. Additionally, he will seek surcharge for the lost income from the XYZ stock or similar investment that would have maximized lifetime income. Sis will have to make up the shortfall in income from her own funds.

Finally, Henry will seek removal of Sis as trustee. The court may then allow Henry to act as sole trustee or may appoint someone else.

Given Sis's breach of duty, the apparent purpose of the trust, the court will allow all of these remedies.

2. Charitable trusts are enforced by the attorney general, rather than by private action. If Charity is a charitable trust, Henry will not have standing to bring an action.

Assuming Henry has standing as the co-trustee of Wynn's trust, he can seek a constructive trust by tracing the funds from the trust to Charity as used for admin purposes. This will mean that Charity's sole duty as trustee of the constructive trust is to use the funds as directed.

3. California is a community property (CP) state. All property acquired during marriage while domiciled in CA or another CP state is presumed to be CP. All property acquired prior to marriage, or after separation, is presumed to be separate property. Additionally, all property acquired at any time by gift, descent, devise or bequest is presumed to be CP.

All property acquired during marriage while domiciled in a non-CP state that would be CP if domiciled in CA, is presumed to be quasi-CP (QCP). At termination of the marriage, to determine the character of property, a court will look at the source of the funds used to acquire property, any applicable presumptions, and any actions by the spouses that may change the character of the assets. A mere change in form does not alter the character of the asset.

Source:
Here, the source of the funds for the house, which is the sole trust asset, can be traced back to the XYZ stock and further, back to Wynn's earnings as a history professor. Because all earnings by community labor are CP, these earnings would be CP if the spouses had been domiciled in CA at the time they were earned. Thus, by definition, they are QCP (defined supra). During marriage, QCP remains the SP of the owning spouse. At divorce or death of a spouse, the character as QCP affects the property determination.

Presumptions:
All assets acquired during marriage are presumed to be CP. However, as noted, the source of the house is earnings that are Wynn's SP until termination of the marriage. Spouses can also take title in ways that raise a presumption, such as a gift to the community, which arises on death of a spouse under Lucas. However, Wynn kept the funds in a separate account, and then created an irrevocable trust with the funds, so no alteration in the title is shown in the facts.

Actions of the spouses
Spouses can by transmutation or other actions alter the character of their own SP. Henry may argue that the change from Wynn's separate account to a trust is such a transmutation. However, a transmutation, to be valid, must be in writing, signed by the adversely affected spouse and clearly express the intent to transmute. This is not evident here, so no transmutation has taken place.

Distribution of assets

At divorce, QCP is treated as CP, and this would entitle Henry to half of the QCP. Death also impacts the character, depending on which spouse dies. If the SP owner (Wynn) predeceases the non-owning spouse, the non-owning spouse may choose their forced share (take against the will) in order to get to QCP assets. However if the non-owning spouse dies first, they have no right to devise the QCP that belongs to the other spouse.

As a result, Henry has no immediate right in the trust assets. In the event of divorce or death of Wynn, he would acquire such rights as are discussed above.

QUESTION 5: SELECTED ANSWER B

1. What is the likely result of Henry's suit against Sis

A trustee owes fiduciary duties of loyalty and care to the beneficiaries of a trust. A trustee may bring suit against a co-trustee for breaching the fiduciary duties, and move to have the violating trustee removed from their position.

A. Duty of Care

Generally, a trustee owes a duty of care to the beneficiaries to act as a reasonably prudent person under similar circumstances. This includes the duty to prudently invest trust property in a manner that will create the greatest return for the benefit of the trust.

i. Prudent investment

A trustee has a duty to prudently invest trust funds so as to increase the benefits from investments for the trust beneficiaries. Here, Sis sold all of the XYZ stock in the trust and used the proceeds to pay for a house. Sis will argue that this is a prudent investment because XYZ stock had decreased in value by 10%, whereas the value of the house has appreciated 20%. This increased the value of the trust property. However, Henry will likely argue that to tie up all of the trust assets in one piece of property which potentially can fluctuate wildly in the real estate market is not a prudent investment. Instead he will argue that Sis should have diversified to different stock from other companies other than XYZ in order to keep a more stable and broad base for the trust property.

Based on these arguments, it is likely that Henry will prevail against Sis in arguing that exchanging all of the stock into one parcel of real property is not a prudent investment.

ii. Duty to diversify

A trustee also has a duty to diversify the stock held by the trust. Here, as discussed above, the trust initially only held XYZ stock. Henry will argue that Sis had a duty to diversify the stock to include stocks from other corporations, and that consolidating the trust assets into one piece of property which is less liquid and potentially subject to market fluctuations in price and value violated the duty to diversify.

A. Duty of loyalty

A trustee is a fiduciary and owes a duty of loyalty to the beneficiaries and the trustor of the trust. Therefore, Sis has a fiduciary duty of loyalty to act solely in the best interest for the trust.

i. Duty to avoid self-dealing

A trustee has a duty to avoid self-dealing with respect to trust assets. The trustee must obtain court approval before the sale of any property which benefits the trustee personally. Here, Sis sold all of the trust assets and used the proceeds from the sale to purchase a house in which she lives in rent-free. She is therefore using trust assets for her own personal benefit, which is impermissible absent court authorization. She has a duty to pay fair market rent to the trust for use of the property in order to avoid a claim of self-dealing.

Therefore Sis has arguably violated her duty to avoid self-dealing

ii. Fairness to all beneficiaries

A trustee also has a duty to act impartially and fairly towards both the income and the principal beneficiaries. The trustee cannot favor one beneficiary over another in terms of their investments or distributions. Here, whereas Wynn and Charity are both

income beneficiaries of the trust currently, Charity is the only principal beneficiary after Wynn's death.

(a) "Income"

Income beneficiaries are entitled to cash dividends from stocks, and rents from property held by the trust. Initially XYZ stock issued substantial dividends which are considered income to the trust and distributed to the income beneficiaries. Therefore Wynn and Charity were sharing the substantial income beneficiary. However, as noted above, the stock declined in value and therefore was worth 10% less, therefore reducing the future value for the principal beneficiary.

However, upon changing the stocks for the house, the principal beneficiary would obtain a 20% increase in value of the property. However, Sis is not paying any rent for the property, and therefore Wynn is no longer getting an income from the trust as a result of this change. This change, coupled with the lack of rental payments by Sis, means that Henry will likely be successful in arguing that Sis has violated her duty to act fairly and impartially towards both income and principal beneficiaries.

D. Conclusion

Because of the aforementioned breaches in duty, it is likely that Henry will prevail against Sis in claiming a breach of trust. The trust would likely be entitled to a constructive trust for the unpaid rent that was due on the propety, and Henry may have Sis removed as trustee for breaching her duties of care and loyalty.

2. What is the likely result of Henry's suit against Charity for return of the income

A. Purpose of a charitable gift

A trust must have a valid purpose in order to be properly formed. Here, part of the trust's express purpose at the time of formation was for income from the trust to be delivered to Charity but only go towards disaster relief. Charitiable contributions and trusts are considered valid purposes and therefore the trust is permissible.

B. Violation of a condition by a beneficiary

However, a violation by a beneficiary of an express condition of the trust violates the trust purpose. The court will look at the totality of the circumstances to determine whether the language was intended to merely express a wish on the party of the trustor, or rather if it is an express condition for receipt and use of funds. Here, the trust had an express condition that the share of income given from the trust to Charity was only to be used for disaster relief. However, the beneficiary here instead used the funds for administrative expenses, not disaster relief. The Charity will likely argue that it was only a general wish because they would receive the full benefit of the property upon Wynn's death and therefore should be able to use and dispose of trust income in any manner that benefits the charity. However, Henry will likley argue that the express terms of the trust are explicit in requiring that the funds only be spent on disaster relief. Therefore the beneficiary has violated an express term of the trust.

C. Remedy for violation by a beneficiary

If a beneficiary violates an express term of a trust, the trustee can sue for return of the income used in violation of the trust terms. Therefore Henry would likely prevail in a suit against Charity for return of the income.

3. What rights does Henry have in the trust assets?

All property acquired during marriage in CA is presumed community property (CP). However, property acquired by (1) gift or inheritance; (2) expenditure of separate property funds, (3) the rents, profits, or income derived from separate property; or (4)

acquired before the marriage are presumed to be separate property (SP) of the acquiring spouse.

A. Quasi-Community Property

If a married couple acquires property in a non-community property state that would have been community property had the couple been residents of a community property state, such items are considered "quasi-community property" (QCP) and are potentially subject to community property laws if the couple later moves to a community property state. During the marriage, the QCP is treated as SP of the acquiring spouse. However, upon divorce or death of the acquiring spouse, the QCP will be treated as CP and divided equally between the spouses. Upon the death of the non-acquiring spouse, the property will remain the SP of the acquiring spouse.

B. Wages earned during marriage

Wages, earnings, and pensions earned during marriage are considered CP, absent an agreement between the spouses agreeing otherwise. Here, Wynn earned a salary working as a history professor while living out of CA. Regardless of whether she kept the earnings in a separate account, in CA the earnings would be considered CP. The facts do not show that Wynn and Henry had any agreements changing the character of the property. Therefore upon moving to CA, Wynn's earnings are presumed to be QCP. However, as noted above, they retain their SP characterization until death or divorce.

C. The trust assets

Wynn and Henry are still married at the time that Wynn sets up the trust fund with $100,000 of her earnings. Even though these funds are earmarked as potential QCP, during the marriage they are still considered the SP of the spouse who earned them. Therefore at this time, Henry does not have any interest in the trust assets because of

the ongoing marriage. Henry will not have any possible rights to the trust assets until death or divorce.

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ESSAY QUESTIONS AND SELECTED ANSWERS

FEBRUARY 2015

CALIFORNIA BAR EXAMINATION

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Question Number	Subject
1.	Contracts
2.	Real Property
3.	Civil Procedure
4.	Remedies
5.	Business Associations
6.	Wills/Trusts

QUESTION 6

In 2011, Tess, age 85, executed a valid will, leaving all her property in trust for her grandchildren, Greg and Susie. Income from the trust was to be distributed to the grandchild or grandchildren then living each year. At the death of the last grandchild, any remaining assets were to go to Zoo for the care of its elephants.

In 2012, the court appointed Greg as conservator for Tess, because of Tess's failing mental abilities.

In 2013, the court authorized Greg to make a new will for Tess. Greg made a new will for Tess leaving Tess's entire estate to Susie and himself outright. Greg, without consulting Tess, then signed the will, in the presence of two disinterested witnesses, who also signed the will.

In 2014, Tess found a copy of the will drafted by Greg, and became furious. She immediately called her lawyer, described her assets in detail, and instructed him to draft a new will leaving her estate in trust to Susie alone and excluding Greg. Income from the trust was to be distributed to Susie each year. At Susie's death, any remaining assets were to go to Zoo for the care of its elephants. The new will was properly executed and witnessed.

In 2015, Tess died. That same year, Zoo's only remaining elephant died.

Zoo has petitioned the court to modify the trust to provide for the care of its animals generally.

1. Is Zoo's petition likely to be granted? Discuss.

2. What rights, if any, do Greg, Susie, and Zoo have in Tess's estate? Discuss. Answer according to California law.

QUESTION 6: SELECTED ANSWER A

1. Zoo's Petition to Modify the Trust

Trust Creation

The issue is whether Tess's will created a valid charitable trust. A trust may be created either inter vivos or by testamentary trust in a will. A trust is created when there is a present intent to create a trust, a trust beneficiary, a trustee, a trust res, and a valid trust purpose. Here, it appears that Tess intended to create a trust via her will and that her property was the trust res. Although Tess did not name a trustee, a court will ordinarily appoint an appropriate trustee rather than allow a trust to fail for lack of trustee. The trust has appropriate beneficiaries because the portion of the trust intended for the benefit of Tess' grandchildren has identifiable and ascertainable beneficiaries, and the valid trust purpose of supporting the grandchildren from the income.

A charitable trust is a trust for a public charitable purpose, such as health care, education, or religion. A charitable trust may be of perpetual duration and need not identify ascertainable beneficiaries. In addition, the doctrine of cy pres applies to charitable trusts. When a charitable purpose becomes impossible or impracticable, under the doctrine of cy pres the court will determine whether there is an alternative charitable purpose that comes as near as possible to the settlor's charitable intent or whether the settlor would prefer the trust to fail. Here, the remainder of the trust after the death of the grandchildren is a charitable trust because the assets are to go the Zoo for the care of the elephants. Because the elephants died after Tess's death, her express charitable purpose of caring for the elephants is no longer possible. However, it is likely that the court will apply cy pres to direct the trust to the Zoo for the care of other animals or to another zoo with elephants for their care. It is not clear that Tess had a specific connection to this Zoo or to elephants in particular during her lifetime, such that she intended the trust to remain valid only if Zoo took care of elephants with the money. Rather, it appears that she had a general charitable intent, and the court will direct the trust funds to the charitable purpose as near as possible to her intent. Accordingly, Zoo is likely to be able to modify the trust under the cy pres doctrine.

(The gift to the Zoo does not fail under the Rule Against Perpetuities because it vests in the Zoo within 21 years after a life in being at the time of the creation of the trust. Under the Rule Against Perpetuities a gift will fail if it need not vest within the time of a life in being plus 21 years. The grandchildren were lives in being and the trust passes to the Zoo immediately upon the death of the last grandchild. Therefore, the gift over to the Zoo does not violate RAP. The charity-to-charity exception does not apply because the grandchildren are not a charity.)

Conclusion

The court will likely grant Zoo's petition to modify the trust to provide for the care of its animals generally under the doctrine of cy pres.

2. Rights to Tess's Estate

Validity of 2013 Will

The issue is whether the 2013 will validly revoked Tess's 2011 will. Generally, a validly executed will may be revoked by an act of physical revocation or by the execution of a subsequent valid will that either expressly revokes the earlier will or is inconsistent with the terms of the earlier will. If it is inconsistent in terms, the earlier will is revoked only to the extent of the inconsistency. The later will must be validly executed with all of the required formalities. A will is validly executed when there is testamentary capacity, present testamentary intent, the will is in writing, the will is signed by the testator (or signed at her direction and in her presence), there are two witnesses who jointly witness the signature or affirmation of the signature, and the two witnesses sign the will before the death of the testator with knowledge that it is the will they are signing. If the witnessing formalities are not observed, it may nonetheless be considered a valid will if the will proponent provides clear and convincing evidence that the testator intended the document to be her will. Holographic wills are permitted in California if all material terms are in the testator's handwriting.

Here, Tess executed a valid will in 2011 pouring her property into a trust that was created by the terms of the will. In 2013, Greg attempted to revoke the earlier will by

making a new will that was inconsistent with the earlier will by making an outright gift of all of the property. Thus, the 2011 will was properly revoked if the formalities were observed by the 2013 will. Because the court appointed Greg as conservator and authorized him to create a new will for Tess, Greg's capacity and present intent to create the will are at issue. No facts indicate that Greg did not have capacity or that he did not presently intend to create the will in 2013. The will was in writing and Greg signed it on behalf of Tess. Although Tess did not direct that he sign the will (and indeed she was not even aware of it), Greg had been appointed conservator and so he was authorized to sign on her behalf. The will was signed in the joint presence of two disinterested witnesses, and they also signed the will before Tess's death. Thus, all of the formalities were observed and the 2013 will became Tess' valid will, revoking the 2011 will by implication.

Undue Influence or Abuse of Relationship

The issue is whether the will or some portion of it was invalid because Greg exerted undue influence or abused his conservatorship in some way. Undue influence occurs when a person exerts influence over a testator to the extent that the testator's free will is overcome. If that happens, the portion of the will that was made because of the undue influence is invalidated. If that portion was made to a person who would take by intestacy, the gift is invalidated only to the extent of the intestate share. Undue influence is presumed where a person is in a confidential relationship with the testator, had a role in procuring the will, and an unnatural gift results. Here, Greg has not exerted undue influence over Tess because he did not need to prevail on her to change her will. Instead, he was appointed conservator and given authority to change the will himself. Thus, the gift will not be invalidated because of undue influence.

However, the court might decide that Greg abused his position as conservator by changing the will in a way that was contrary to Tess's intent, without ever consulting her as to her wishes. A conservator generally has fiduciary-like duties to the individual he is representing, and thus he must act loyally and in her best interests. Greg's change of the will benefitted him directly, in a way directly contrary to Tess's express wishes at a

time when she had mental capacity. Thus, the court might find that Greg's conduct violated his duty to loyally represent Tess's interests. In that case, his gift would likely be reduced to his intestate share. However, if Tess's property passed by intestacy, it would go equally to Susie and Greg as Tess's only living heirs. This is exactly the will that Greg made. Therefore, Greg would receive the gift he gave himself when he was abusing his authority. In that case, the court might impose a constructive trust on Greg's property for the benefit of Zoo.

(In practical effect, Greg's wrongdoing does not matter because Tess was able to execute a valid will revoking his 2013 will, see below.)

2014 Will

The issue is whether Tess's 2014 will properly revoked the 2013 will created by Greg. As stated above, a will is created when there is present testamentary intent, testamentary capacity, a will in writing, signed by the testator, witnessed by two joint witnesses, and signed by the witnesses before the testator's death.

Testamentary capacity exists when the testator understands the nature and extent of her property and knows the natural objects of her bounty. Here, when Tess called her lawyer in 2014 she was able to describe her assets in detail and provide a reasonable explanation for leaving her assets entirely to Susie. Although Greg will argue that she lacked capacity because he had been appointed conservator in light of Tess's failing mental abilities, testamentary capacity may exist even when the testator lacks capacity to manage his finances and other personal affairs. Under the circumstances, it appears that Tess had capacity to understand her assets and who she wanted to leave them to, and the court will likely find that she had capacity.

Tess also appeared to have present testamentary intent because she instructed her attorney to draft a new will. The facts also state that the will was properly executed and witnessed. Therefore, the 2014 will validly revoked the 2013 will because it was completely inconsistent with that will.

Accordingly, at Tess's death in 2015, the 2014 will leaving her entire estate in trust with income distributed to Susie during her lifetime and remaining assets to the Zoo at the time of Susie's death was Tess's valid will.

Omitted Child

Greg might attempt to argue that he is entitled to an intestate share of Tess's estate as an omitted child. If a child born after the creation of a will (or the testator mistakenly believed the child was dead or did not know he had been born) is unintentionally omitted from the will, the child may take his intestate share and all other gifts are abated. However, Greg is a grandchild not a child, and he was alive at the time the will was made and intentionally omitted because Tess was angry that he had attempted to change her will. Thus, Greg will not be entitled to an intestate share as an omitted child.

Remainder to Zoo

As noted above, the gift to Zoo after Susie's death does not violate the Rule

Against Perpetuities. It is a valid charitable trust, and the court will likely apply cy pres to prevent the trust from failing.

Conclusion

Greg has no rights in Tess's estate. Susie has a right to income from the trust during her lifetime and Zoo has a right to distribution of the trust assets upon Susie's death.

QUESTION 6: SELECTED ANSWER B

1. Zoo's Petition.

The Issue here is whether Tess created a valid will and trust that left Zoo any interest in T's property.

2011 - Will

A valid will must be in writing. It must be signed by the testator in the presence of two disinterested witnesses at the same time who also sign the will.

The facts state that T created a valid will, so we can assume she met all elements of the will. Therefore, a valid will was created.

Trust

T left all of her property in trust for her grandchildren. In order for a trust to be valid, there must be a testator, a beneficiary, trustee, trust purpose, and trust property.

Testator

Here, T is the testator.

Beneficiaries

T's grandchildren Greg and Susie are the income beneficiaries b/c they get the income from the trust. The Zoo is also a beneficiary and they hold a future interest in the property. The Zoo will get the remainder of the trust after the last grandchild dies.

Trustee

Although there isn't a named trustee, it doesn't defeat the trust. The court will appoint a trustee if there is no trustee to manage the trust.

Trust Purpose

The purpose of the trust is to provide income to the grandchildren for their lives, then the remainder goes to the zoo.

Trust property

T has left all of her property into the trust.

Therefore, a valid trust was created. Under the 2011 will, Zoo had an interest in T's trust.

2013 - New Will

The issue is whether the new will is valid b/c it was created by a court appointed conservator.

Will Formalities

See rules above.

Here, Greg as the conservator for T and under the court's authorization created a new will for Tess. The will was signed by two disinterested witnesses. However, T did not sign the will. But Greg will argue that as the conservator, he was permitted to sign on her behalf. So, technically, a will was properly created. However, I will discuss below why the will should be void.

Greg as Conservator

A court can appoint a guardian or conservator to act on behalf of a person who lacks the mental capacity to act on their behalf. They have the authority to make legal decisions, such as drafting a new will. However, a conservator still owes the testator a fiduciary duty of care and loyalty. The conservator must act in the best interest of the testator and not make any decisions that are self-serving and are directly adverse to T's interest.

Here, Greg was appointed as a conservator for T b/c of her "failing mental abilities." Although he is authorized to create a new will for T, he must uphold his fiduciary duties. Greg violated his fiduciary duties when he created T's new will without first talking to her about the will and determining whether she was okay with changing the will so that it left the entire estate to Greg and Susie. Instead, Greg disregarded her previous will and left the entire estate himself and his sister Susie, cutting the Zoo completely out of the will. The act of leaving everything to himself and his sister shows self-dealing and he has violated his duty of loyalty. Even though he was legally permitted to create a new will for Tess, he violated his fiduciary duty to T. Any attempt Greg makes to argue that he was within his right to draft the new will will fail b/c he violated his fiduciary duties. T's estate could sue Greg for violating this duties and seek a request to void the 2013 will.

Undue Influence

Additionally, the Zoo and T's estate will argue undue influence per se b/c there was a fiduciary relationship with the person who wrote the will and there was an unnatural devise.

Here, Greg is the conservator and in a fiduciary relationship with T. The devise was also unnatural b/c the original will never intended to leave the entire estate to Susie and Greg. Therefore, the Zoo and T's estate should be successful in voiding the will under undue influence per se.

DRR

Alternatively, the Zoo and T's estate could attempt to revive the original will under DRR.

Under DRR, a previous will can be revived if a most recent will was created under fraud or misrepresentation. Meaning that the testator created the new will because they were misinformed about something (i.e., a beneficiary had died when they were really alive). If that is the case, then the new will can be voided and the old will can be revived.

Here, T's estate and the Zoo will argue that T would have never created the new will that Greg created. Greg fraudulently misrepresented T's wishes for her will and created an unnatural devise. As discussed above, T never intended to leave her entire estate to Greg and Susie. There is nothing in the facts that suggests she had changed her mind since 2011. Therefore, the 2013 will should be voided and the 2011 will should be revived.

2014 Will Drafted by Lawyer

After T discovered that Greg created the 2013 will, T created a new will. The issue here is whether a valid will was created for lack of capacity.

Will Formalities

See rule above. Here, the facts state that the new will was properly executed and witnessed. So, let's assume that will formalities have been met.

Lack of Capacity

Generally, a person lacks capacity if they are unable to understand the nature of their estate, the nature of their relationship with family and friends, and the nature of their act of creating the will.

Here, the biggest problem is that the court appointed a conservator for T b/c of her failing mental abilities. Other than that, we don't know much about her capacity to create a will. We don't know if "failing mental abilities" equates to lack of capacity. Let's look at the elements for capacity.

Nature of the act

This element means that the T must understand the nature of her acts and conduct of creating the will.

Here, T appears to understand the nature of her act of creating the will because she saw the will that Greg drafted and became furious and contacted her lawyer to draft a new will. It appears that T understood the nature of her act b/c she knew that Greg's 2013 will was not what she intended and she knew that she needed to call her lawyer to draft a new will. Therefore, this element is met.

Nature of the estate

This elements means that the testator must understand the extent of and identify his property.

Here, T understand the nature of her estate and property b/c she revised her will describing her assets in detail and left her entire estate to Susie. Thus, this element is likely met.

Nature of relationships with family and friends

This element means that the testator must understand their relationship with family and friends - the people they are leaving their assets to.

Here, T seems to understand the nature of her relationships b/c she was so angry at Greg for what he did that she specifically excluded him from her new will. She left all of estate in trust to Susie with the remainder to the Zoo. Thus, this element is likely met.

Therefore, since T appears to have met all the elements for capacity at the time that she created the will, the 2014 will is probably the valid enforceable will. The 2014 will revokes all prior wills automatically. If the court agrees that T had capacity at the time that she created her will, then T's 2014 will is probably valid and Zoo has an interest in T's estate.

Cy Pres

The next issue is Zoo's ability to use the assets b/c the trust assets were left for the care of its elephants but they have no elephants. Under the Cy Pres doctrine, the court can modify a charitable trust purpose if the trust purpose has been frustrated.

Here, T's trust left anything remaining in the trust to Zoo for the care of its elephants. The facts don't indicate that Susie has died yet, so the Zoo's interest is still a future one. Because the Zoo doesn't have any present interest in the trust, the Zoo will most likely fail in petitioning the court to modify the trust purpose. Although the Zoo doesn't have any elephants at this time, they might have elephants when Susie dies. If at the time that Susie dies, the Zoo doesn't have elephants, then the Zoo might have a better chance at succeeding in modifying the trust purpose. If they are successful in modifying the trust purpose, the new purpose must also be charitable and the court will probably want them to keep the charitable purpose as close as possible to what the original trustor intended the purpose to be. Therefore, Zoo's petition is premature. The court should dismiss it at this time b/c they do not have any present interest and the purpose of the trust is not currently frustrated.

2. Rights of Greg, Susie, and Zoo.

See discussion above regarding the beneficiaries' rights.

Disposition

Greg

Based on the 2014 will, Greg has no interest in T's assets. Of course, if the court determines that T lacked capacity to create the 2014 will, then Greg might be able to income from the trust from the 2011 will. The 2011 will will only be valid, if the 2013 will that Greg fraudulently created is void and the 2011 will is revived.

Susie

Susie has interest in the trust income for her life under the 2014 will. As discussed above, the 2013 will is likely invalid, so Susie won't get share T's entire estate with Greg. If the court determines that the 2014 will is invalid, then Susie gets trust income for life under the 2011 will.

Zoo

Zoo has a future interest in the remainder of the trust for the care of its elephants under the 2014 will.

Will/Succession

ESSAY QUESTIONS AND SELECTED ANSWERS
JULY 2001 CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the July 2001 California Bar Examination and two selected answers to each question.

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QUESTION 6

Ted, a widower, had a child, Deb. He had three brothers, Abe, Bob, and Carl.

In 1998, Abe died, survived by a child, Ann. Ted then received a letter from a woman with whom he had once had a relationship. The letter stated that Sam, a child she had borne in 1997, was Ted's son. Ted, until then unaware of Sam's existence, wrote back in 1998 stating he doubted he was Sam's father.

In 1999, Ted executed a will. With the exception of the signature of a witness at the bottom, the will was entirely in Ted's own handwriting and signed by Ted. The will provided that half of Ted's estate was to be held in trust by Trustee, Inc. for ten years with the income to be paid annually "to my brothers," with the principal at the end of ten years to go "to my child, Deb." The other half of the estate was to go to Deb outright. One month after Ted signed the will, Ted's second brother, Bob, died, survived by a child, Beth.

In 2000, Ted died. After Ted's death, DNA testing confirmed Ted was Sam's father.

What interests, if any, do Deb, Sam, Ann, Beth, and Carl have in Ted's estate and/or the trust? Discuss. Answer according to California law.

ANSWER A TO ESSAY QUESTION 6

In re: Estate of Ted (T)

I will first discuss the validity of the will, and then discuss the terms of the will, which includes the trust. Then I will discuss how the estate should be distributed, according to those terms, and then how that distribution would be altered by Sam's claims.

I. Validity of Will

Under California law, a valid will must be signed by the testator, signed or attested before two witnesses at the same time, who know the items in a will, and who then sign the will. Further, the testator must have the intent that this document be his will.

Here, while the will was signed by T, it was not properly witnessed -- it appears only one witness signed, and the law requires that two sign. Therefore, this will does not comply with will formalities.

However, this will is valid as a holographic will. Holographic wills are valid in California. A holographic will is one in which all of the material terms of the will -- testamentary intent, property to be distributed, and intended beneficiaries -- are all in the testator's handwriting (intent can be found as a commercially prepared will form, but that is not applicable here). Next, the holographic will must be signed by the testator.

Here, those requirements are met. The entire will was written by T (under the witness' signature), so the material portions are in T's handwriting (he expressed his intent, disposed of his property, and named his beneficiaries) and he signed the will.

II. Terms of the Will

Half of the estate goes to Deb (D). The other half goes to the trust.

A trust is a disposition of property which separates equitable title, held by the beneficiaries, from the legal title, held by the trustee. The trustee must manage the trust for the benefit of the beneficiaries.

A. Validity of Trust

For a trust to be valid, there must be: 1) a trustee; 2) funding of the trust; 3) ascertainable beneficiaries; and 4) no violation of public policy.

Here, a trustee has been named -- Trustee, Inc. Even if Trustee, Inc. is not actually still in existence, the trust will not fail. Trusts do not fail for want of a trustee -- the court will just name one.

Next, the trust has ascertainable beneficiaries. The trustee must be able to identify the

recipients of the trust. Here, Deb may argue that the beneficiaries are not ascertainable because none are listed by name. However, here there is a class gift. T left the income of the trust for 10 years "to his brothers." A trustee can identify his brothers.

D may argue this class gift violates the Rule against Perpetuities. Under the rule, an interest must vest if at all with 21 years of a life in being at execution. Here, D would argue that T could still have more brothers. However, at T's death, the class closes due to the Rule of Convenience, so the interest vests.

Next, the trust is funded by the transfer from the will to the trust at death. This is called a testamentary trust and is valid.

Finally, there is no improper purpose for this trust. Therefore, the trust is valid.

III. Distribution

Here, I will discuss the distribution as if Sam's claims are denied. I will discuss the impact of his claims on this distribution later.

A. Deb's ½ of Estate in the will

Deb takes this share outright.

B. Distribution of trust.

As discussed above, the income of the trust is distributed to T's brother for ten years. The issue is which brothers or their issue share in this class gift.

When T died, Carl was still alive, and Abe and Bob had already died. Carl will argue that he is the only surviving member of this class, so he takes the ½ interest outright. He would argue that Abe and Bob's interests had lapsed, and so failed.

However, California has an anti-lapse statute. Under the statute, if: 1) the dead beneficiary was related to the testator, 2) the dead beneficiary was survived by issue, and 3) there is no contrary intent, then the dead beneficiary's issue represent him and take his share. In California anti-lapse also applies to member of a class gift, unless a member of that class died before execution and the testator knew that.

Here, Bob died one month after T executed the will, so he qualifies for anti-lapse application under the statute. Further, Bob satisfies the statute -- he is related to T (his brother), he is survived by issue (Beth) and there is no contrary intentions in the will, like a survivorship clause. Therefore, Beth joins Carl in the class.

However, Abe died before execution of the will, and provided T knew this, which he probably did because people usually know when their siblings die, Abe does not qualify for protection under the statute because he fails the class gift requirements. Therefore, even though Abe

satisfied the statute, Ann cannot avail herself of the statute and so will not join the class.

Therefore, Carl and Beth are entitled to the income from the trust for 10 years. Once the ten years are up, Deb gets the principal and therefore, the entire estate.

IV. Sam's Claims

Sam, if he can prove he is T's son, has several claims.

First, Sam must prove he is T's son. During life, Sam could prove paternity by admission of T, being listed on a birth certificate with T as father, or by being born in marriage between his mom and T. Here, during T's life paternity was never established. T wrote back to Sam's mom saying he doubted he was Sam's father, and T was unaware Sam existed, so they never held out a relationship.

After death, paternity can be proven, but it must be by clear and convincing existence. Here, DNA confirmed T was S's father, which is convincing and clear evidence, so Sam can pursue the following claims.

1. Pretermitted Child

By statute, a child born after execution of a will can take an intestate share if he was not taken care of in the will, outside of the will, there is no contrary interest, and the parent did not leave most of the estate to the surviving spouse.

Here, S was born in 1997. T learned of this in 1998. T executed his will in 1999. Therefore, because T executed his will after S was born, S cannot avail himself of this statute.

2. Unknown Child

By statute, a child born before the will was executed, who was not provided for in the will or outside the will in other instruments, is entitled to an intestate share if the testator did not know of the child's existence, and did not provide for the child because of that belief, either by mistakenly believing the child was dead or never born.

Deb will argue that T knew of Sam's existence when he executed the will. T received a letter in 1998 telling him he was Sam's dad. Therefore, Sam cannot qualify under the statute.

Sam will argue that, although T knew Sam existed, he did not know Sam was his child. This proof did not come out until after T died, with the DNA testing. Sam will argue that had T known S was his child, T would not have omitted him.

However, that belief must be the but/for cause of the omission. Here, it appears that T was not interested in Sam -- he made no attempt to determine paternity, or to establish a relationship with Sam, so Sam cannot qualify under this statute.

If he did, he would get an apportioned share of the entire estate.

ANSWER B TO ESSAY QUESTION 6

Validity of Will: CA recognizes the validity of wills that are valid under CA law or the law of other states where a person executed the will. I will assume Ted died and executed his will in CA.

CA recognizes attested, statutory and holographic wills. A holographic will must be signed by the testator and the material provisions in the handwriting of the testator. Here, Ted signed the will and the entire will, which would include material provisions, was in his handwriting. Therefore, the will is valid.

Validity of Trust: A will may create a trust. Ted's will created a trust. A trust must have: (1) settlor with capacity. Ted is a settlor and has capacity. (2) Present intent to create: Ted intended [that] his will create the trust. (3) Trust property existing and ascertained. Ted's estate meets this requirement. (4) Beneficiaries existing within the rule of perpetuities. All Ted's provisions require that beneficiaries take within 10 years. Therefore, all beneficiaries will be existing within the Rule Against Perpetuities, and (5) Valid Purpose: A trust for relatives is a valid purpose. Further, Ted already has a trustee. The trust is valid.

Ann, Beth and Carl:
Carl: Carl definitely takes a share of the trust income because he is a surviving member of a named class: "Ted's Brothers." The share he takes, however, depends on the claims of everyone else.

Beth: Any rights Beth have come from her father, Bob. Bob predeceased Ted. Therefore, Bob and his issue do not take under the instrument. However, Beth may take under CA Anti-lapse, which states: if a beneficiary predeceases the Testator (Note: Anti-lapse applies to all testamentary instruments including trusts), that person's issue takes his share unless a contrary intent. Class gifts are included in Anti-lapse. Therefore, Beth will take her father Bob's share. (See Ann for more Anti-lapse)

Ann: Same analysis except as Abe's daughter as Beth until Anti-lapse. Another exception to anti-lapse is that if a class gift is made and one member of the class is dead when made, anti-lapse does not apply to that person if testator knew he was dead.

Here, Ted likely knew his brother Abe was dead (Abe died in 1998) when he made his will in 1999. Plus, Abe is a member of a class gift. Therefore, Ann will not take unless Ted did not know of Abe's death; then she will take his share of anti-lapse.

Deb: Deb will take the shares described in the instrument because the trust and will are valid. However, her share may be altered by Sam's claims.

Sam: Sam will not take under the instruments. Sam may take under CA's Omitted Child

Provisions. Since Ted died in 2000, the omitted child provisions apply to all testamentary documents.

An omitted child is a child: born after execution of the instrument(s), thought dead, or not known by testator to be born.

Here, Ted knew of Sam, but did not know Sam was his child. However, after execution of the instrument(s) and in fact after Ted's death, DNA proved Sam was the child of Ted. Therefore, Sam may qualify as constructively being born after execution or that he was not known to be born. One of these arguments should work because as to Ted Sam was not known to be born.

Therefore, the omitted child provision should apply unless Ted provided for Sam outside the instrument, intended to exclude or gave most property to the surviving parent.

Deb will argue that Ted intended to exclude Sam because Ted knew of Sam and doubted that he was Sam's father. Deb's argument likely fails because Ted never knew Sam was his child and neither of the other exceptions even remotely qualifies.

Therefore, Sam will very likely take his omitted child's share, which is his intestate share.

Sam's Intestate Share: Since Ted had no surviving spouse, his issue are his intestate successors. Ted had two issue, Deb and Sam. The intestate share is ½ of Ted's estate each. However, since Deb takes under the will, she does not take under intestacy.

Sam's Share: ½ the estate prior to it going into the trust or to Deb if he is an omitted child. If not, he gets nothing.

Summary:
1. Beth and Carl likely split the trust income for 10 years unless Ted did not know of Abe's death. In that case, Ann, Beth and Carl split the income.

2. Deb takes the principal of the trust after 10 years and ½ the estate outright subject to Sam's interests.

3. Sam likely takes ½ the estate before any other dispositions are made. Or he takes nothing.

ESSAY QUESTIONS AND SELECTED ANSWERS

JULY 2002 CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the July 2002 California Bar Examination and two selected answers to each question.

The answers received good grades and were written by applicants who passed the examination. The answers were prepared by their authors, and were transcribed as submitted, except that minor corrections in spelling and punctuation were made for ease in reading. The answers are reproduced here with the consent of their authors and may not be reprinted.

QUESTION 1

Theresa and Henry were married and had one child, Craig. In 1990, Theresa executed a valid will leaving Henry all of her property except for a favorite painting, which she left to her sister, Sis. Theresa believed the painting was worth less than $500.

On February 14, 1992, Theresa typed, dated, and signed a note, stating that Henry was to get the painting instead of Sis. Theresa never showed the note to anyone.

In 1994, Theresa hand-wrote a codicil to her will, stating: "The note I typed, signed, and dated on 2/14/92 is to become a part of my will." The codicil was properly signed and witnessed.

In 1995, Theresa's and Henry's second child, Molly, was born. Shortly thereafter, Henry, unable to cope any longer with fatherhood, left and joined a nearby commune. Henry and Theresa never divorced.

In 1999, Theresa fell in love with Larry and, with her separate property, purchased a $200,000 term life insurance policy on her own life and named Larry as the sole beneficiary.

In 2000, Theresa died. She was survived by Henry, Craig, Molly, Sis, and Larry.

At the time of her death, Theresa's half of the community property was worth $50,000, and the painting was her separate property. When appraised, the painting turned out to be worth $1 million.

What rights, if any, do Henry, Craig, Molly, Sis, and Larry have to:

1. Theresa's half of the community property? Discuss.

2. The life insurance proceeds? Discuss.

3. The painting? Discuss.

Answer according to California law.

ANSWER A TO ESSAY QUESTION 1

Theresa's half of the Community Property

The parties' rights to Theresa's (T) one-half of the community property (CP) depends upon the validity of her will and upon CP legal principles.

California is a CP State. All property acquired during marriage is presumed CP. All property acquired before married is presumed separate property (SP). Also, property acquired after permanent physical separation is presumed SP. In addition, property acquired any time through gift, devise, or descent is presumed SP.

In order to characterize assets, courts allow tracing to the source of funds used to acquire the asset. Generally, a mere change in form will not alter the characterization of an asset.

At death, a testator has testamentary power to dispose of one-half of her CP and all of her SP.

Here, T had the power to dispose of her ½ of the CP.

Validity of T's 1990 Will

In 1990, T executed a valid will. Thus, it is presumed that the will was properly signed and attested by two witnesses.

T left "all of her property" except the painting to Harry (H). Thus, H is the beneficiary of T's ½ of the CP.

A will can be revoked by a subsequent express written instrument or by an inconsistency. Here, T wrote a note in 1992 and a hand-written codicil in 1994. Both of these documents relate to the painting and not T's CP.

It does not appear that either document expressly revoked the 1990 will. Also, there are no facts indicating that the 1990 will was revoked by physical act.

As a result, H would offer the 1990 will into probate and argue he is entitled to all of T's ½ of CP valued at $50,000.

Molly's Rights as Pretermitted Heir

Molly may argue she was omitted from T's will because she was not born yet. Thus, Molly may argue she is entitled to share of T's CP.

A pretermitted child is one born or adopted after a will was executed. The omitted child is entitled to an intestate share unless the omission was intentional; the child was provided for outside the will or the property was left to a parent when another child was alive at the time of the execution.

Here, Molly was born in 1995, which is after the 1990 will was executed. However, all of the property was given to H. Furthermore, Craig, another child, was alive when the 1990 will was executed. As such, Molly would be unable to recover under this exception.

Also, Molly would only by entitled to her interstate share. Under California law, when a person dies without a will allows their CP goes to a surviving spouse. Here, even if T died without a valid will, H would take all of the property under intestacy laws. Molly would only be entitled to a portion of T's SP.

Thus, Molly has no right to T's CP.

Craig's Rights to T's CP

Craig is not a pretermitted child because he was alive at the time the 1990 will was executed. Also, similarly to Molly, Craig would have no right to T's CP under intestacy laws.

Sis and Larry's Rights to T's CP

Sis is T's sister. The intestate laws do not allow a sibling to take the testator's CP when the surviving spouse with rights to that CP is still alive. T did not devise any of her CP to Sis. As such, Sis has no rights in T's CP.

Larry appears to have been someone T fell in love with after H left. T never devised any of her CP to Larry. Larry has no rights in T's CP.

H will take T's CP worth $50,000.

T's Life Insurance Proceeds

Ordinarily under CP principles, proceeds from a whole life insurance are CP to the extent they were acquired during marriage. The time rule is applied to determine the CP interest. Proceeds from a term life insurance policy are generally the type of the last premium paid.

H may argue in 1999 when T bought the life insurance policy they were still married and therefore the $200,000 is CP. If so, Larry as the named beneficiary would only be entitled to $100,000 as T has power to dispose of her ½ interest.

Larry would argue T and H's marriage had ended. A community ends with a physical separation with the intent not to resume. Larry will argue H left and joined a commune. Larry would assert this shows H's intent to end the marriage.

Larry will also argue and CP presumptions will be rebutted by tracing the source of the life insurance proceeds. T bought the life insurance with her own SP. Therefore, Larry will successfully argue even if T was still married and her economic community had not yet ended, she used her SP to acquire the policy.

Since T used SP to buy the policy, the $200,000 proceeds would be SP as well. A mere change in form does not alter the characterizations of property. Thus, Larry would argue as the sole beneficiary he should take all the proceeds since T has the power to dispose of all her SP.

Craig and Molly's Rights to the Life Insurance Proceeds

The children may attempt to argue they have a right to a portion of the $200,000. However, they will not succeed. They were both alive when T made this "will

substitute" and T had the power to give the proceeds all to Larry and none to them.

Sis also has no claim to the proceeds.

Thus, Larry is entitled to all of the life insurance proceeds valued at $200,000.

The Painting

T's 1990 Will

In her 1990 will, T devised the painting she thought was worth $50,000 to Sis. Therefore, under the 1990 will, Sis is entitled to the painting.

The Effect of the 1992 Note

A codicil is an instrument made after the execution of a will that disposes property. A codicil must be executed with the formalities of a will.

Formal Attested Codicil

In order for typewritten codicil to be given effect it must be signed by the testator. Also, the testator must sign or acknowledge her signature or will in front of two witnesses. Those two witnesses must sign the will with the understanding that it is a will.

Here, T did type, date and sign a note in 1992. This note purported to change her 1990 will so that H got the painting and not Sis.

However, T never showed the note to anyone. That implies she never had two witnesses sign the note. Also, she never acknowledged her signature or will to two witnesses. Therefore, it was not properly attested to. As a result, the codicil will not be given effect.

Holographic Codicil

A holographic codicil is valid when all material provisions are in the testator's handwriting and she signs it.

Here, the note was typed and so it was not handwritten. Thus, it will not be given effect.

Revocations by Express Subsequent Codicil

A will can be revoked by a codicil. However, the codicil must be valid and meet the formalities of a will in order to be given effect as a revocation.

Here, as shown above the codicil was not executed by proper formalities. Thus, it did not revoke the 1990 will.

By itself, the 1992 note has no effect on the 1990 will. Thus, Sis would still be the beneficiary.

Effect of the 1994 Codicil

The codicil written in 1994 was handwritten. It was also properly signed and witnessed. It appears T was attempting to validate her 1992 not by stating "the note I typed on 2/14/92 is to become a part of my will."

Incorporation by Reference

A document can be incorporated by reference. It must have been in existence at the time of the will execution, sufficiently described in the will and reasonably been the document the will was referring to.

Here, the note was in existence at the time the codicil was written. The codicil was written in 1994 as is attempting to incorporate the 1992 note. The codicil did sufficiently describe the note by stating "The note I typed, dated and signed on 2/14/92." The description accurately gives the date the note was made.

H would offer the note and argue it sufficiently was described. Also, H will argue the note is the document the codicil was referring to.

As such, a court may find that the prior defective note has now been republished and reexecuted by this 1994 codicil that was handwritten and signed. Even though a holographic codicil does not require attested witness, the fact that it was properly witnessed should not preclude the court from finding it a valid holographic codicil.

Therefore, it is very likely H will prevail and will take the painting over Sis.

Craig and Molly's Rights to the Painting

The children may argue since T was significantly mistaken about the painting value, the gift to either Sis or H is invalid.

The children will attempt to argue if T knew the painting was worth $1 million she would have not given it to Sis. Rather she would have left it to them.

A court will not likely agree with this argument. Existing evidence of a mistake is generally allowed if it is reasonably susceptible with the will.

Here, it is not reasonable to assume T would have given it to Craig and Molly. She may have left it to H as she did not in the codicils.

Therefore, the children likely have no right to the painting.

They may argue H's rights were revoked by operation of law.

A gift to a spouse is revoked upon divorce.

Here, T and H never divorced. As such, H likely takes the painting because a legal separation may not be enough to invoke revocation by law.

ANSWER B TO ESSAY QUESTION 1

1. Theresa's (T's) Half of Community Property

California is a community property state. Under California law, a spouse may dispose of one half of the community property through her will. The provisions of T's will will control the $50,000 (her half of the community property) unless a legal presumption prevents or alters application of the will.

1990 Will

The 1990 will was "validly executed" (a will is validly executed when signed with testamentary intent by a testator before two witnesses who know that the document is a will). The devise of $50,000 to Henry (H) and the painting to Sis (S) are therefore valid unless modified by later wills or legal presumptions.

1992 Note Is Not Valid Alone But Is Valid After 1995 Codicil

The 1992 note was not a valid modification when written. The note is typed and unwitnessed (never shown to anyone). A codicil to a will must satisfy the same formalities of execution, as the original will. A codicil is valid if made with testamentary intent before two witnesses who knows the document is a will. Here, T never showed the note to anyone, so it is unwitnessed.

Holographic Wills – unwitnessed wills prepared by the testator – are valid only if signed and if the material provisions are written in the testator's handwriting. Here, the codicil was typed and therefore the material provisions are not handwritten, and the codicil is not a valid holographic codicil.

1994 Codicil Validly Incorporates the 1992 Note For Reference

The 1994 Codicil was handwritten, signed and properly witnessed, and affirmed to the disposition of the 1992 note. Under the doctrine of incorporation by reference, a valid will can incorporate disposition in the other documents so long as the other documents are (1) clearly identifiable from the instrument's language and (2) in existence and the time of the referencing document's creation. Here, the 1992 note is clearly identified by date and character (typed, signed), and was in existence when 1994 codicil was executed.

The facts indicate that the 1994 note was properly witnessed, indicating that it satisfied the requirements of a formally attested will. Even if it did not, it is handwritten and signed, so would be a valid holographic will. Typed documents may be incorporated by reference into a holographic will.

The wills clearly leave the $50,000 share of T's community property to H, who will take unless some legal presumption prevents him from doing so.

Separation is No Bar to H's Taking

After Molly executed her last codicil, H left her and joined a commune. Under California law, when a married couple divorces after execution of a will, neither takes under the other's will executed before divorce (each spouse's will is read as if the other had died), unless the will has been republished or the gift reaffirms through conduct.

Here, however, T & H have not divorced but have only separated. The divorce presumption will not apply unless T & H reached a legally binding property settlement. If they did so, H does not take under the will and the community property passes heirs through intestacy statutes – her children Molly (M) and Craig (C) will each take $25,000. If no settlement was reached H still stands to take all $50,000.

Pretermitted Child

M was born after the T executed all wills. Under California law, a pretermitted child (one born after execution of all wills and not provided for in wills by class gift) may take an intestate share of the parents' property.

In this case, Molly's intestate share would be ⅓ of the estate (including the painting) since there is one surviving spouse of T and two surviving children. Craig is not pretermitted since he was born prior to the execution of the last will – his omission is presumed to be intentional.

The pretermitted child presumption does not apply if there is evidence the testator allocated funds for the child in another way, such as a separate inter vivos gift, or if there is an older non-pretermitted child who is omitted, with the bulk of funds left to their children's parent. The latter situation is the case here – by omitting Craig from her will and leaving the bulk of her estate to H, T evidenced intent to allow H to provide for the children. Their separation

does not affect this presumption. The pretermitted child rule will not apply, and H will take the full $50,000.

2. H will take the Painting under the 1994 codicil

As discussed above, the 1994 codicil is valid and validly incorporates the 1992 note by reference. A codicil to a will will be read as consistent with the will wherever possible. Where inconsistent, the later document controls.

Here, the 1994 codicil's incorporation of the note giving the painting to H not S is inconsistent with the prior gift to S, so the later gift to H controls. Again (see above), H will take the painting despite the marital separation, unless H & T signed a valid property distribution agreement, in which case the divorce (see above for discussion) presumption will apply and H will take nothing under the will and the painting will pass through intestacy to M & C.

3. Life Insurance

Life insurance is will [sic] a named beneficiary does not pass through probate with the will. The named beneficiary will receive so long as the insurance policy is wholly separate property.

California is a community property state. Earnings during marriage are presumed community property (CP), while earnings outside of marriage, gifts, devices and inheritances are presumed separate property (SP). The character of any asset can be determined by tracing it to funds used to purchase it, unless a legal presumption or conduct applies to change characterization.

A marriage community ends upon separation with permanent intent (intent not to reunite). T & H separated in 1995 and H went to live in a commune – a court would likely regard this as intent to separate permanently which dissolved the community.

A term life insurance policy buys the designated protection for a term of one year. Therefore a term policy is designated CP or SP by tracing to the most recent payment. T took the policy out in 1999, after the community dissolved. Assuming she used post-community earnings or other SP to pay for the policy, it will be SP and pass completely to Larry.

ESSAY QUESTIONS AND SELECTED ANSWERS

FEBRUARY 2003 CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the February 2003 California Bar Examination and two selected answers to each question.

The answers received good grades and were written by applicants who passed the examination. The answers were prepared by their authors, and were transcribed as submitted, except that minor corrections in spelling and punctuation were made for ease in reading. The answers are reproduced here with the consent of their authors and may not be reprinted.

QUESTION 2

Olga, a widow, owned Blackacre, a lakeside lot and cottage. On her seventieth birthday she had a pleasant reunion with her niece, Nan, and decided to give Blackacre to Nan. Olga had a valid will leaving "to my three children in equal shares all the property I own at my death." She did not want her children to know of the gift to Nan while she was alive, nor did she want to change her will. Olga asked Bruce, a friend, for help in the matter.

Bruce furnished Olga with a deed form that by its terms would effect a present conveyance. Olga completed the form, naming herself as grantor and Nan as grantee, designating Blackacre as the property conveyed, and including an accurate description of Blackacre. Olga signed the deed and Bruce, a notary, acknowledged her signature. Olga then handed the deed to Bruce, and told him, "Hold this deed and record it if Nan survives me." Nan knew nothing of this transaction.

As time passed Olga saw little of Nan and lost interest in her. One day she called Bruce on the telephone and told him to destroy the deed. However, Bruce did not destroy the deed. A week later Olga died.

Nan learned of the transaction when Bruce sent her the deed, which he had by then recorded. Nan was delighted with the gift and is planning to move to Blackacre.

Olga never changed her will and it was in effect on the day of her death.

Who owns Blackacre? Discuss.

Answer A to Question 2

Olga owned Blackacre and had a valid will leaving to her three children "in equal shares all the property I own at death." If the terms of the will were to take effect while Olga owned Blackacre, her three children would share in Blackacre equally. However, she had a reunion with her niece Nan, and had decided to make a present conveyance of Blackacre. She drew up a deed with the help of her friend Bruce, gave the deed to Bruce, and, without Nan's knowledge, instructed Bruce to "record it if Nan survives me." Later, Olga attempted to revoke her alleged gift to Nan by destruction of the deed, however, Bruce did not destroy the deed. When Olga died, Bruce conveyed the deed to Nan. In order to determine who owns Blackacre, the central question to answer is whether Olga made a valid conveyance to Nan. A second question is whether Olga appropriately revoke[d] the conveyance to Nan. If Olga is found to have appropriately conveyed Blackacre [to] Nan, the three children would not take any share of Blackacre under the terms of the will. On the other hand, if Olga did not appropriately convey Blackacre to Nan, the three children would take Blackacre in equal shares, and Nan would not get anything. A final consideration is whether there was any reliance on Nan's part that would allow Nan to take Blackacre.

Did Olga make a valid conveyance of Blackacre to Nan?

In order to find that Olga validly conveyed Blackacre by deed to Nan, three elements must be present. First, there must be an intent by the grantor, Olga, to convey Blackacre to the grantee Nan. Secondly, there must be a valid delivery of the deed to Nan. And thirdly, Nan must validly accept the deed and Olga's conveyance.

Did Olga have an intent to convey Blackacre to Nan?

In order to possess valid intent, Olga must have intended to convey Blackacre to Nan at the moment she made delivery. It is not enough that Olga possess the requisite intent to convey Blackacre to Nan years before delivery is made. The intent must match the moment of delivery.

Here, the facts indicate that Olga intended to "effect a present conveyance." This wording implies that her intent was to convey Blackacre at that precise moment. Olga therefore had Bruce draw up a deed which complied with deed formalities of description of property, names involved, and Olga's signature. Olga then handed the deed to Bruce, stating, "Hold this deed and record it if Nan survives me." When Olga handed the deed to Bruce, the facts state that she intended to transfer Blackacre to Nan at that precise moment. However, her conduct does not match the wording of "present

conveyance." Instead, Olga wanted Bruce to "hold this deed, and record it if Nan survives me." This language is indicative that Olga did not want to make a precisely present conveyance of Blackacre. Instead, Olga wanted Nan to receive Blackacre upon the happening of a condition, that Nan survive Olga. Olga manifested the intent that should Nan not survive Olga, Nan should not get Blackacre. Olga intended that at that moment, Nan was to receive a contingent remainder in Blackacre, and was not intended to be a present conveyance. Instead, Olga intended to remain holder of the deed to Blackacre, and leave open whether her children should take under her will.

This contingent remainder should be distinguished from a fee simple determinable. A fee simple determinable transfers an interest in land; however, should a condition occur, then the land will revert back to the grantor through possibility of reverter. Here, a court will most likely find that Olga did not intend to convey any type of defeasible fee, but instead wanted to convey a contingent remainder.

Nan would disagree with the characterization that Olga intended to convey a contingent remainder. Instead, Nan would argue that Olga intended to make a present possessory conveyance of Blackacre to Nan when she handed the deed to Bruce. However, the language which Olga used, indicating that there was a condition before the deed should be recorded, indicates that there was also a condition before the deed was to become possessory in Nan. This characterization will also depend on whether Bruce is an agent for Nan, or an agent for Olga as shall be discussed later.

Olga's children will argue alternatively that the intent does not match the delivery at all, that Olga's intent was to make a present possessory transfer of Blackacre, that her actions do not match, and therefore, the whole transaction should be invalidated. However, courts are unwilling to invalidate a transaction simply on technicalities. Instead, courts will try to look at the transferor's intent in giving effect to a transaction, use that for guidance, but still rely on legal principles, justice, and fairness in coming to a decision. Therefore, most likely, a court will not invalidate Olga's attempt to convey Blackacre to Nan, solely because her words do not match her actions. Instead, a court will construe her intent reasonably.

Did Olga make a valid delivery of the deed to Nan?

Conveyance of a deed also requires valid delivery of the deed from the grantor to the grantee. Such conveyance does not have to be a precise handing of the deed from the grantor to the grantee. Instead, there can be a constructive conveyance. The grantor could hand the deed to a third party, who could in turn hold the deed for the grantee. A finding of whether there was a valid delivery in such a situation rests upon which party

the third party is an agent for.

In the present case, Olga handed the deed to Bruce, with precise instructions to record the deed should Nan survive Olga. It is clear that there was a valid delivery from Olga to Bruce. But the question is whether Bruce is an agent for Nan, or Olga.
The facts support the conclusion that Bruce is an agent for Olga. The facts describe Bruce as a "friend" of Olga, and a person whom Olga could turn to for help in drafting a deed. Furthermore, Bruce helped Olga draft the deed with a form, and for all purposes, seems to be on Olga's side. The facts also indicate that Bruce was to act on behalf of Olga. Bruce was to convey the deed to Nan, and record the deed, should Nan survive Olga. T[he]se actions on behalf of Olga and other aid to Olga are indicative of an agency relationship. A court will most likely find that Bruce is an agent for Olga.

The facts do not support a finding that Bruce is an agent for Nan. The facts do not show that Nan even knew Bruce, and for all purposes, seems to have first heard from Bruce when Bruce sent her the deed. Because Bruce is not acting on behalf of Nan, but rather on behalf of Olga, a court w[il]l most likely find that Bruce is Olga's agent, and not Nan's.

A finding of this sort is significant. If Bruce is an agent for Olga, then when Olga gave the deed to Bruce, delivery was not yet made. Delivery would happen upon the occurrence of the specified condition, and Bruce would transfer the deed to Nan, using the power which Olga granted to Bruce to act on Olga's behalf. On the other hand, if Bruce is an agent for Nan, then delivery was complete upon Olga's delivery to Bruce. All that would remain is for the deed to be accepted.

Because a court will most likely find that Bruce is an agent for Olga, a court will also most likely not find that there was a valid delivery made to Nan at the moment Olga gave the deed to Bruce. Instead, a court may find that a valid delivery was made when Bruce, acting as agent for Olga, transferred the deed to Nan, because Olga empowered Bruce to act in her interest.

Was there a valid acceptance by Nan?

In addition to an intent to deliver by the grantor and a valid delivery by grantor to grantee, there must also be a valid acceptance by the grantee in order for a valid conveyance of a deed to take place. As indicated above, Bruce will most likely be found to be an agent for Olga. Thus Bruce cannot accept on behalf of Nan. If Bruce had been an agent for Nan, Bruce could accept the deed on behalf of Nan. Instead, the facts indicate that Nan did not even know of anything of the transaction. Nan could not accept until Bruce sent the letter to Nan.

When Bruce did send the letter to Nan, Nan accepted the transfer. This is indicative as Nan "was delighted" and intended to move to Blackacre. Thus, if there was not an effective revocation of Bruce's power to transfer the deed to Nan, then the deed should be effective in favor of Nan.

Significance of Olga's revocation

These findings are significant because of the revocation which Olga made. A revocation is valid anytime up to the moment of acceptance. In the present case, there was not even a valid delivery, let alone a valid acceptance at the moment Olga handed the deed to Bruce. A court MAY find that there was a valid delivery and acceptance when Bruce transferred the deed to Nan, but only if Bruce was st[il]l empowered to transfer the deed to Nan. Nan would argue that Bruce remained empowered to transfer the deed because Bruce did not use substantially the same instrument and means to revoke her gift as she did to make it. Generally, such transfers are terminable by any reasonable means. Olga's children would argue that even if there was not a valid delivery or acceptance, the revocation was effective upon the phone call, that is, was reasonable to revoke her offer by telephone rather than in writing because Olga and Bruce were friends.

A court will probably hold that the revocation was not effective. Although this is a scenario for the transfer of land thus subject to the statute of frauds, a finding that a person can revoke or reinstate a transfer simply on a whimsical phone call would invite the danger of too much fraud. If Olga could effectively terminate her transfer by a phone call, then she could just as easily reinstate her offer. Such ease in a transfer of something as substantial as a transfer of land would invite too much danger of abuse and fraud. Hence, a court will probably hold that Olga's revocation was invalid.

Conclusion

A court will most likely hold that Olga had an intent to deliver land to Nan. Although her intent may not coincide precisely with her actions, a court will construe a reasonable intent to deliver. Olga conveyed the property to Bruce as her agent who in turn was empowered to deliver the deed to Nan. Olga's revocation was ineffective because it did not comply with the statute of frauds. Hence, when Nan accepted the deed, a court will probably find an effective conveyance.

Should the court not find an effective conveyance, Nan could also pursue a theory of reliance. However, the facts do not support too much of a finding of reliance, as Nan did not take any substantial action, and instead, "planned" to move to Blackacre. A plan

is not sufficient to justify a finding of reliance. There must be also a significant manifestation of intent to possess.

Answer B to Question 2

The issue is whether the deed form was sufficient to pass title to Nan and make her the owner of Blackacre, or whether the deed was invalid, which would mean that Olga was owner of Blackacre upon her death and the property would pass through her will to her three children in equal shares.

1. Deed

In order for a deed to be valid there must be: (1) a writing that satisfies the statute of frauds; (2) delivery; and (3) acceptance.

A. Statute of Frauds

When conveying an interest in land, the conveyance must be contained in a writing that satisfies the statute of frauds. A deed is sufficient to satisfy the statute of frauds if it: (1) identifies the parties to the conveyance; (2) sufficiently describes the property to be conveyed; (3) and is signed by the grantor. In this case, Blackacre is a piece of real property that consists of a lakeside lot and cottage, and a sufficient writing must exist in order for the conveyance to be enforceable.

Here, the deed form is a written memorandum which identifies the parties to the conveyance. The deed names herself as grantor and Nan as grantee. The deed also sufficiently identifies the property to be conveyed. The deed designates that Blackacre is the property being conveyed and the deed includes "an accurate description" of Blackacre. Also, Olga, as grantor, signed the deed. In general, the signature of a deed does not have to be notarized; however, in this case the deed was notarized by Bruce after Olga acknowledged her signature. Therefore, it appears that the deed form was a written memorandum that is sufficient to satisfy the statute of frauds requirement for conveying an interest in land.

B. Delivery

To determine whether a grantor has sufficiently delivered a deed so as to affect a conveyance of real property, the focus of the inquiry turns on the grantor's intent. If the grantor intends to pass a present interest in the property, then delivery is complete. Actual physical delivery of the deed is not required, nor is knowledge of the delivery by the grantee, so long as the grantor possessed the requisite intent.

Here, Nan would argue that at the time Olga executed the deed form she had the

present intent to convey Blackacre to her. Olga and Nan were family members and had just had a "pleasant reunion" for Olga's seventieth birthday. In addition, Olga did not want her children to know that she was leaving Nan Blackacre while she was alive. Thus, this shows that Olga has the present intent to pass title to Nan while she was alive. Moreover, the deed form by its terms would effect a present conveyance of the property.
On the other hand, Olga' s children may argue that Bruce merely provided Olga with the deed form, and Olga did not know that it would effect a present conveyance. Even though the terms were sufficient, Olga's children would argue that she lacked the requisite present intent as evidenced by Olga handing the deed to Bruce and telling him to hold the deed and only record it if Nan sur[v]ived her. Olga's children would argue that this demonstrates that Olga did not intend for the deed form to pass to present title and therefore Olga never 'delivered the deed' to Nan. Olga's children would also note that Olga's intent not to pass present title to Nan is shown by Olga's telephone call to Bruce in which she instructed Bruce to "destroy the deed".

On balance, because at the time of the conveyance Olga executed the deed sufficient to convey title and she wanted to make a gift of the property to Nan at that point, even though she didn't want her children to know about it, a court would likely find the deed was sufficient to convey title to Nan at the point it was executed by Olga. Olga did not state that she only intended the deed to be effective upon the occurrence of an event, rather Olga merely stated that she wanted Bruce to record the deed if Nan survived her. A deed does not have to be recorded in order to be valid. Therefore, Olga likely delivered the deed.

C. Acceptance

A grantee must accept the deed of conveyance. In general, acceptance is presumed unless the grantee has specifically indicated an intent not to accept the conveyance. Instead, it is immaterial whether Nan knew about the conveyance or not when Olga "delivered" the deed. Therefore, Nan's lack of knowledge would not prohibit a finding that she "accepted" the deed. In fact, as further evidence of her acceptance, Nan "was delighted" with the gift and planned on moving to Blackacre. Thus, there was sufficient acceptance.

As a result, because there is a sufficient writing to satisfy the statute of frauds, and Olga intended to make a present transfer of the Blackacre when she executed the deed and Nan's acceptance can be presumed, Nan owns Blackacre. Because the property is not part of Olga's estate at the time of her death because she did not own it anymore, her three children would not receive Blackacre in "equal shares" pursuant to Olga's will. A

testator may not devise property which she does not own at her death.

However, if the court found that Olga did not possess the requisite intent to deliver Blackacre to Nan, Nan could still argue that Olga's deed form constituted a valid disposition by will and therefore she would still take the property.

2. WILL - Is the Deed Form a Valid Will?

In general, a will is valid if the testator is at least 18 years old and of sound mind, possesses the requisite testamentary intent, signs the will in the joint conscious presence of 2 witnesses that understand the document is the testator's will and who sign the will. Some jurisdictions recognize the validity of holographic wills. To be valid, a holographic will must be signed by the testator, the testator must possess testamentary intent, and the material provisions of the holographic will must be in the testator's handwriting. Material provisions of the will consist of identifying the beneficiaries and the property to be devised.

In this case, the deed form would not be a valid formal will because Olga executed the document in the presence of only 1 witness, Bruce. Thus, even though Olga was over 18 and appears to be of "sound mind", and she signed the deed, the deed form does not qualify as a valid formal will.

Nan could argue that the deed form constitutes a valid holographic will. The deed form was signed by Olga, and it appears that "Olga completed the form" by naming herself as grantor and Nan as grantee, and by including the property to be conveyed, Blackacre, and accurately described the property. Thus, the [the] "material terms" of the will appear to be in Olga's handwriting. It does not matter that the document was a "form" so long as the material terms were in Olga's handwriting. Therefore, the court may conclude that Olga executed a valid holographic will if it concludes that at the time Olga possessed the necessary testamentary intent.

Nan would argue that Olga's statement to Bruce instructing him to hold the deed and record it if "Nan survives me" evidences a testimony intent that Nan only take the property upon Olga's death. Thus, Nan would not have an interest in the property until Olga dies, which is consistent with disposing of one's property by will. A court would likely conclude that the deed form constitutes a valid holographic will.

3. Revocation of Holographic Will

In general, wills are freely revocable during the testator's lifetime. A will may be revoked by a physical act or by execution of a subsequent instrument.

In order to revoke a will by physical act, the testator must (1) have the intent to revoke, and (2) do some physical act such as crossing out, destroying, obliterating which touches the language of the will. A testator may direct another person to destroy the will, however, the destruction must be at the testator's direction and in the testator's presence.
Here, Olga's children could argue that the deed form, which constitutes a holographic will, was revoked by Olga before her death. Olga intended to revoke the will when she called Bruce and told him to "destroy the deed". Olga's children may argue that even though Bruce did not actually destroy the deed, the court should still find that Olga possessed the intent to revoke. However, because Bruce was not in Olga's presence and did not do anything to the language of the holographic will, it is likely that Olga did not sufficiently revoke the holographic will before her death.

4. Revocation of Earlier Will

If the court found that Olga did not revoke the holographic will, then the issue becomes whether the holographic will is sufficient to revoke the earlier valid will leaving all of Olga's property to her three children equally. A testator may revoke a prior will by executing a subsequent instrument. In general, a subsequent written instrument that qualified as a will must be construed, to the exent possible, as consi[s]tent with the prior instrument. However, to the extent that a subsequent instrument is inconsistent with prior will, the prior will is revoked.

Here, the holographic will leaves Blackacre, which was part of Olga's "property" to Nan. Olga's original will left "all the property that I own at my death" to her three children. If the court finds that the deed form was insufficient to pass title to Nan during life because Olga lacked the necessary intent, she would "own" Blackacre at her death. If the deed form constitutes a valid holographic will, it disposes of Blackacre. Thus, this disposition would work a revocation of the original will to the extent that it is inconsistent. Therefore, Nan would take Blackacre under the holograph will, and Olga's children would take the rest of Olga's property since that would not be inconsistent with the original terms of the will.

Olga's children may argue that Olga never dated the holographic will, and therefore, when a testator is found to have a formal will and a holographic will that is undated, a

presumption exists that the holograph was executed before the holograph [sic]. Thus, the formal will would be inconsistent with the undated holograph, and the formal will would, to the degree of inconsistency, revoke the undated holograph. In that case, Olga's children would own Blackacre equally, and Nan would take nothing.

In sum, Nan likely own[s] Blackacre because the deed form was sufficient to pass present title to her, and therefore Olga did not own Blackacre at her death. As such, her original will would not pass Blackacre to her children since she did not "own" it at her death. In addition, even if the court finds that Olga lacked the requisite intent for a valid delivery, the deed form likely qualifies as a valid holographic will which Olga did not revoke in her lifetime.

ESSAY QUESTIONS AND SELECTED ANSWERS

JULY 2003 CALIFORNIA BAR EXAMINATION

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Question 6

In 1998, Tom executed a valid will. The dispositive provisions of the will provided:

"1. $100,000 to my friend, Al.
2. My residence on Elm St. to my sister Beth.
3. My OmegaCorp stock to my brother Carl.
4. The residue of my estate to State University (SU)."

In 1999, Tom had a falling out with Al and executed a valid codicil that expressly revoked paragraph 1 of the will but made no other changes.

In 2000, Tom reconciled with Al and told several people, "Al doesn't need to worry; I've provided for him."

In 2001, Beth died intestate, survived only by one child, Norm, and two grandchildren, Deb and Eve, who were children of a predeceased child of Beth. Also in 2001, Tom sold his OmegaCorp stock and reinvested the proceeds by purchasing AlphaCorp stock.

Tom died in 2002. The will and codicil were found in his safe deposit box. The will was unmarred, but the codicil had the words "Null and Void" written across the text of the codicil in Tom's handwriting, followed by Tom's signature.

Tom was survived by Al, Carl, Norm, Deb, and Eve. At the time of Tom's death, his estate consisted of $100,000 in cash, the residence on Elm St., and the AlphaCorp stock.

What rights, if any, do Al, Carl, Norm, Deb, Eve, and SU have in Tom's estate? Discuss.

Answer according to California law.

Answer A to Question 6

1. AL

Al was initially provided with $100,000 under the valid 1998 will.

Codicil

A codicil is a supplement to an existing will executed with full formalities according to the statute of wills that revokes only inconsistent provisions of the prior will and adds new provisions. Both the codicil and prior will (consistent) are valid and deemed executed as of the date of the codicil.

Thus, by executing a valid codicil in 1999, T revoked the inconsistent paragraph 1. At common Law T may have been required to also make additions, but that is not the law in California.

Revocation

A will, and codicils, can be revoked expressly by a subsequent will or by physical act.

Expressly

A will can be revoked by a subsequent holographic express revocation. For a valid holographic will the Testator must sign and the material provisions must be in T's handwriting.

Here, Tom wrote the words "null and void" in his own handwriting and signed the codicil. Therefore he likely revoked the codicil expressly.

By Physical Act

Tom also may have revoked by physical act, which can be done by crossing out language of the existing will or writing null and void so long as language of the revoked instrument is touched.

Here T wrote the words across the face of the codicil touching the language and therefore it likely also could be interpreted as revocation by physical act.

Therefore the codicil was validly revoked. . . .

Revival

Where a codicil to a will is revoked the validly executed will remains valid. Whether the inconsistent provisions are thus revived depends on evidence of the intent of the testator.

Al will point to the statements by Tom to several people that T said, "Al doesn't need to worry, I've provided for him."

However, SU will likely argue it is unclear whether these statements were made near time that T revoked the codicil. They were made, however, after T and Al reconciled, so likely Al can use these statements and their later reconciliation to show he intended to revive the will.

Dependent Relative Revocation

T likely cannot rely on Dependent Relative Revocation, which provides that where the T revokes a will under mistaken belief that a prior gift is valid the revoked will will be revived. This does not aid Al because he does not want the gift in the codicil revived, as there is no gift for him there.

Therefore, if the codicil is revoked, Al likely prevails under the existing valid will and will get the $100,000.

2. Carl/The Stock

Whether Carl will take the AlphaCorp stock depends on whether Tom's initial gift was specific or demonstrative, because specific gifts generally are deemed if they do not exist when the T dries.

Specific vs. Demonstrative

Specific gifts are gifts of specifically identified property, like a piece of real estate or a watch. Demonstrative gifts are a hybrid of specific and general in that the T intends to make a general devise but identifies the source from which the devise should come.

Stock has proved difficult to characterize. Gifts of "my 100 Shares of ABC" are generally deemed specific, while '100 shares of ABC' are demonstrative.

Here, T gives Carl 'his OmegaCorp Stock'. This is more like a specific devise because it is phrased in the possessive which suggests T intends to give specific stock.

Ademption

Under the doctrine of ademption specific devises that are not present when T dies are adeemed by extinction. This rule of ademption is not applied to demonstrative gifts. Instead, such gifts are satisfied out of other property.

Here, the OmegaCorp stock has been sold and thus not present when T dies. Thus, if this is a specific devise, the gift to Carl is adeemed.

Change In Form, Not Substance

Carl may argue that the gift is not adeemed because it is still present. He could argue that Tom's purchase of the AlphaCorp stock with all the proceeds was a change in form not substance.

Intent of the Testator

Carl could also argue that in California if the T did not intend ademption to apply it will not be applied. Here, Carl is Tom's brother, a natural object of T's bounty and there is no indication of bad blood between the brothers. Therefore T can be argued there was [sic] no attempts to adeem.

Acts of Independent Significance

Carl may also argue that the doctrine of Acts of Independent significance applies. This allows blanks in a will to be filled in by acts that are not primarily testamentary. Selling stock has a lifetime motive and thus is not primarily testamentary. However, there is no blank in the will here, which expressly identifies OmegaCorp stock, not just 'my stock.' Therefore this argument will fail.

Norm, Deb & Eve/The Residence

Lapse

Under the common law doctrine of lapse, a beneficiary who predeceased the testator did not take the gift. It lapsed. Here, Beth died in 2001, one year before Tom. Under common law her gift would lapse.

Anti-Lapse Statute

In California, there is an anti–lapse statute that will save gifts to beneficiaries who predecease if:

1) they are related to T or to T's spouse;

2) they leave issue.

Here, Beth is T'S sister and thus is related. Further, she leaves issue, one child, Norm, and two grandchildren, Deb and Eve, who are the children of her predeceased other child. Therefore, California's anti-lapse statute applies.

Under California's anti-lapse statute, the gift goes directly to the decedent beneficiary's issue, not to devisees under the will.

Here, Beth's issue are Norm and Deb and Eve (the issue of her issue). Under California intestacy law, which applies Modern Per Stirpes [sic], the gift would go to Beth's issue.

Deb and Eve may then take by representation for their deceased parent. Thus Norm would take ½ and Deb and Eve would split ½, for 1/4 each.

4. Remainder/SU

SU will take all the remainder of the estate less costs for administration, etc. Here, if Earl's gift is adeemed, SU takes the AlphaCorp stock. If Al's gift in will 1 is not revived somehow, SU takes that as well.

Answer B to Question 6

Rights of Al

A valid codicil may, expressly or impliedly, by conflict revoke a gift in a prior will. The codicil here expressly revoked the gift to Al.

Revocation of Codicil

In California, revocation by be [sic] express by a new instrument or by physical act of revocation by the testator, including mutilation, tearing, burning, etc that is intended to revoke. Writing "null and void" across the text of the will was a physical act of destruction and was coupled with the signature indicating that Tom performed the act. Because it was probably intended by Tom as a revocation of the codicil, the codicil was revoked.

Revival of the gift to Al

Generally, revocation of a later instrument will not revive an earlier will. However, in California, where revocation is by physical act, a former instrument is revived based on testator's intent to revive the prior instrument, whole or in part. This intent may be shown by extrinsic evidence.

Comments to Several people

Al will wish to use the comments to other people that Tom provided for Al to show that Tom intended to revive his original bequest to Al. Hearsay is a statement made out of court offered for the truth of the matter asserted. Here, Al would be offering these statements for the truth of the matter. However, an exception to the hearsay rule exists for state of the mind of the declarant. Normally, this exception only applies to current state of the mind of the declarant. Normally, this exception only applies to current state of mind or future intent. However, and [sic] a testimony exception exists for prior statements concerning the declarant's will. Because Tom's statements are being offered to show that Tom intended to revive the gift, Tom's testamentary intent, it falls within the exception [to] the hearsay rule [sic] and will be admissible.

Given this evidence of intent, under California law, Tom's bequest to Al will probably be reinstated by revival.

Holographic Codicil & republication

In California, a holographic will or codicil is made when the testator writes the testamentary provisions in his own handwriting and signs the instrument. Thus, Al may also argue that by writing "null and void," then signing, created a valid holographic codicil that republished the original will with Al's gift.

Dependent Relative Revocation

Al may also argue that his gift is valid under the doctrine of Dependent Relative Revocation. Under this doctrine, when a gift is cancelled, but [sic] it appears that the testator only did so in the mistaken belief that another valid bequest to that person made [sic] by a new instrument. This doctrine generally applies when a new larger gift is found invalid. Here, however, no new gift was made, thus Al cannot depend on this theory to validate his gift.

Conclusion

Because Al's gift was either revived or republished as part of a holographic codicil, Tom's gift to Al of $100,000 will be enforced.

2. Rights of Norm, Deb and Eve to Elm St. Residence

When a bequest in a will is made to a person who preceases testator, that bequest is said to lapse. Under common law, a lapsed gift failed and fell into the residue of the will. However, under California's anti-lapse statute, when a bequest is made to [a] close relative, the [sic] presumes that the testator intended for the issue of the dead devisee to stand in the deceased shoes and receive the gift. Thus because Beth was the sister of Tom the anti-lapse statute should apply with the bequest going to Norm, Deb, and Eve.

Note that SU may argue that the anti-lapse statute does not apply because Tom's revocation of his codicil was by a holographic instrument (the writing of "null and void", signed by Tom, see analysis above, re: Al) after the death of Beth. The anti-lapse statute does not apply when the will is executed after the death of the devisee. Here, however, the putative holographic codicil is undated, and Tom made his comments about providing for Al in 2000 before Beth's death. Thus this argument will likely fail.

Assuming that Norm, Deb, and Eve, Beth's issue, receive Elm St. under the anti-lapse statute, it will be distributed per capita with representation as defined by the intestacy code. In this case, it will be equivalent to the common law, per stirpes method: Norm will have an undivided ½ interest in Elm St., Deb and Eve 1/4 undivided interests, each as tenants in common.

3. Ademption of Stock gift to Carl

When a bequest of specific property is no longer owned by the testator at death, the bequest is adeemed, and falls into the residue of the estate. Here, SU, the residuary beneficiary, will argue that the gift of "My OmegaCorp" stock was a specific gift, and should thus be adeemed.

At common law, an exception exists when the new property was clearly intended to replace the property mentioned in the will. However, this exception is more likely to be applied to items such as autos or homes than stock. However, Carl will argue that when Tom

replaced OmegaCorp stock with AlphaCorp stock, that the value of the property was not changed and that Tom intended that Carl still receive the stock.

In addition, some common law courts would fudge the classification of a bequest from specific to demonstrative, if they thought it necessary in [sic] for justice and equity. Thus, such a court would classify the stock bequest as a demonstrative gift. Carl would then be entitled to the current market value that the OmegaCorp stock would now have (or the shares purchased for that amount).

In California, however, whether a gift is adeemed is determined solely be [sic] the intent of the testator at the time of the sale of the asset as to whether the new asset was to be a replacement and the bequest not adeemed. Carl would argue that when [sic] Tom directly exchanged the proceeds of the OmegaCorp stock for the AlphaCorp stock, and the act was done for reasons of making a better investment, and not with the intent to redeem. Carl would be able to produce intrinsic evidence in support of this assertion.

Overall, as discussed above, it appears that Carl has a reasonable chance of receiving the AlphaCorp stock, or at least the value of OmegaCorp stock.

4. Rights of SU

SU, as residuary devisee, will have the rights to anything remaining. As stated above, it appears that this will be nothing with the possible exception of the AlphaCorp stock or some remnant of that.

Abatement

As only the property mentioned in the will is available, the estate may not have sufficient funds to pay all of these bequests along with any debts or cost of administration of the estate. In that case, those debts would first come out of any general bequests, and from those, first from non-relatives. Thus regardless of how the gift to Carl is classified, Al's gift will be abated first. If that is insufficient, then the classification of Carl's gift made by the court would be relevant. If found to be a demonstrative gift, it would be abated next. If a specific gift, the abatement would be to both Carl and "Beth"'s [sic] gift proportional to the total size of their gifts.

ESSAY QUESTION AND SELECTED ANSWERS

JULY 2004 CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from July 2004 California Bar Examination and two selected answers to each question.

The answers received good grades and were written by applicants who passed the examination. The answers were prepared by their authors, and were transcribed as submitted, except that minor corrections in spelling and punctuation were made for ease in reading. The answers are reproduced here with the consent of their authors.

Question 3

Hank, an avid skier, lived in State X with his daughter, Ann. Hank's first wife, Ann's mother, had died several years earlier.

In 1996, Hank married Wanda, his second wife. Thereafter, while still domiciled in State X, Hank executed a will that established a trust and left "five percent of my estate to Trustee, to be paid in approximately equal installments over the ten years following my death to the person who went skiing with me most often during the 12 months preceding my death." The will did not name a trustee. The will left all of the rest of Hank's estate to Wanda if she survived him. The will did not mention Ann. Wanda was one of two witnesses to the will. Under the law of State X, a will witnessed by a beneficiary is invalid.

In 1998, Hank and his family moved permanently to California. Hank then legally adopted Carl, Wanda's minor son by a prior marriage.

In 2001, Hank completely gave up skiing because of a serious injury to his leg and took up fishing instead. He went on numerous fishing trips over the next two years with a fellow avid fisherman, Fred.

In 2003, Hank died.

In probate proceedings, Wanda claims Hank's entire estate under the will; Ann and Carl each claim he or she is entitled to an intestate share of the estate; and Fred claims that the court should apply the doctrine of *cy pres* to make him the beneficiary of the trust.

1. Under California law, how should the court rule on:
    a. Wanda's claim? Discuss.
    b. Ann's claim? Discuss.
    c. Carl's claim? Discuss.

2. How should the court rule on Fred's claim? Discuss.

Answer A to Question 3

3)

1. **UNDER CALIFORNIA LAW, THE COURT'S RULING ON:**

A. WANDA'S CLAIM

Wanda will argue that the will is valid and she is therefore entitled to at least 95% of Hank's estate, as described under the will.

1. Validity of the Will

a. Choice of Law

In order to determine whether the will is valid, it must first be decided what law will apply. The facts state that Hank dies while living in California. A will will be valid if it is valid in the state in which it was executed, the state in which the testator was domiciled at the time of execution, or the state in which the testator died. The will was executed in State X, and while Hank was domiciled in State X. Although the facts state the will would be invalid in State X, it is not necessarily invalid in California, the state in which Hank was living at the time of his death. The following is a discussion of the will's validity in California.

b. Requirements for an Attested Will

Under California law, for an attested will to be valid, it must be signed by the testator in the presence of two disinterested witnesses. An interested witness is one who is a beneficiary under the will. If a witness is "interested", the entire will is not invalid, but there is a presumption that the portion which the interested witnessed[sic] received is invalid.

Under the facts of this case, Wanda was to receive 95% of the estate. In addition, she was one of two witnesses to the will. Therefore, there is a presumption that the portion left to her is invalid. If Wanda cannot overcome this presumption, she will not be left with nothing; rather, she will still be entitled to her intestate portion under the will.

c. Wanda's Intestate Portion

Under intestacy, a spouse is entitled to receive all community property, and at least 1/3 and up to all of her deceased spouse's separate property, depending on whether or not the decedent left any surviving kin. In the present case, Hank left Ann and Carl. Where two children are left, the testator's estate is divided in 1/3 portions among the spouse and the two children. Therefore, Wanda will obtain 1/3 of Hank's remaining estate.

B. ANN'S CLAIM

1. Omitted Child

Ann will argue that she was an omitted child and, in the event the will is found valid in its entirety, other interests should abate and she should receive an intestate portion of Hank's estate. However, Ann will be unsuccessful in this argument because Ann was alive and known about prior to Hank's execution of the will, and she was not provided for on the will.

2. Intestate Portion

Ann will therefore argue that the aforementioned devise to Wanda is invalid and that she is in this way entitled to her intestate portion of the remaining interest. As discussed above, Ann will be entitled to 1/3 of Hank's estate through intestacy.

C. CARL'S CLAIM

1. Pretermitted Child

Carl will first argue that he was a pretermitted child, as he was adopted after the will was executed. Therefore, he will argue that, if the devise to Wanda is valid, her interests should abate to account for his intestate portion. However, the fact that Ann was excluded from the will harm Carl's interest, as this will evidence as intent not to devise any portion of his estate to his children.

2. Intestacy & Adopted Children

Therefore, Carl will argue that the devise to Wanda is invalid and that he should be entitled to a portion of the remainder of the estate through intestacy. The fact that Carl is adopted and not a child by Hank's blood will not affect Carl's portion because under California law, adopted children are treated the same in intestacy as children by blood.

2. **COURT'S RULING ON FRED'S CLAIM**

Hank's Will also included a trust. This is called a pour-over will. In order for the pour-over will to be valid, it must meet the requirements of a valid trust.

A. Validity of the Trust

1. Requirements

In order for a trust to be valid, it must have 1) an ascertainable beneficiary, 2) a settlor, 3) a trustee, 4) a valid trust purpose, 5) intent to create a trust, 6) trust property

(res), and 7) be delivered.

2. Lack of Trustee

The facts state that the trust lac[k]ed a trustee. The lack of a trustee, however, is not fatal, as a court can appoint a trustee to administer the trust.

3. Trust Property

The trust property is clearly identified in the will, as "five percent of my estate...to be paid in approximately equal installments over the 10 years following my death..." Therefore, this requirement is satisfied.

4. Delivery

The delivery requirement is met through the inclusion of the trust into Hank's will.

5. Unascertainable Beneficiary

The fact that the beneficiary is not named poses the biggest problem for the trust. In order for the trust to be valid, a beneficiary must be ascertainable. In the present case, the beneficiary is not named, but rather is described as "the person who went skiing with me most often during the 12 months preceding my death." Courts can use a variety of methods to ascertain the identity of a beneficiary when he or she is not specifically named on a will, such as: Incorporation by Reference or Facts of Independent Significance. Neither one of these are helpful in the present case.

Incorporation by reference allows a testator to incorporate into a will a document or writing if it is in existence at the time of the will, a clear identification is made, and the intent to incorporate is present. In the present case, the identity of beneficiary was not presently in existence. Therefore, this method fails to assist in ascertaining the beneficiary.

Facts of independent significance can also be used to incorporate outside items into a will. Although the identity of the person most frequently skiing with Hank would have independent significance, it is of little help here since Hank suffered a serious injury to his leg and thus gave up skiing. Therefore, this method also fails to assist in ascertaining the identity of a beneficiary.

When there is no ascertainable beneficiary, a resulting trust occurs. This means that the trust property returns to the settler's estate.

5. Cy Pres

Fred, however, will argue that under the doctrine of cy pres, the property should not

be returned to the settlor's estate, but should go to him instead.

Cy pres is a doctrine which provides that, where a charitable trust fails for lack of a beneficiary or other impracticality, the court should apply cy pres and grant the trust property to another charity which conforms with the trust purpose.

In the present case, Fred will argue that the purpose of the trust was to further leisurely sports and camaraderie. Fred will compare fishing with skiing, and argue that the two activities were similar in that they provided the opportunity for friends to come together and enjoy each other. Therefore, because it [sic] the two purposes are so similar, and because Fred went on numerous fishing trips with Hank, Fred will argue that he should be entitled to the trust property.

However, in order for cy pres to apply, the purpose of the trust must be charitable. Under the Statute of Elizabeth or the common law, this trust purpose, however Fred defines it, is not charitable. It does not alleviate hunger, help sick, further education, or health. Therefore, the doctrine of cy pres is inapplicable, and a resulting trust will occur. Therefore, the 5% will retain to Hank's estate and be divided among Wanda, Ann, and Carl accordingly.

Therefore, Fred will get nothing, and Wanda, Ann, and Carl will each get 1/3 of Hank's separate estate, and Wanda will get all of her and Hank's community property.

Answer B to Question 3

3)

1. Under California law, how should the court rule on:

a. Wanda

Wanda (W) claims that she is entitled to Hank (H)'s entire estate under the will. In order to make that claim, the will must first be proved to be valid.

Valid Will?

Choice of Law

The will was executed in State X, and under State X's laws the will would be invalid because a will witnessed by a beneficiary is invalid. W, as a beneficiary receiving the residue of H's estate, was one of the witnesses, and therefore the will would be invalid under the laws of State X.

However, the parties moved and became domiciled in California. Under California law, a will is valid if it complies with the statute of the place where the the will was executed, where the decedent was domiciled when the will was executed, or in compliance with the statute of the jurisdiction where the decedent was domiciled when he died.

Here, while the will is not valid under State X's laws, H was domiciled in California when he died. If the will is valid under California laws, then the will is valid and will be probated. A formally attested will to be valid in California must be in writing, signed by the testator or a third party at his or her direction, in the presence of two witnesses, and the witnesses understand what the testator is signing is his or her will.

Here, the will is valid under California law. First, the will is in writing, and it was executed by H. Further, two witnesses signed the will (but please see "interested witness" below), thus meeting that requir[e]ment. Presuming that the witnesses understood that what H was signing was his will, then California will formalities have been complied with.

Interested Witness

It is important to note that California does not invalidate a will because one of the witnesses is a beneficiary under the will. A witness is interested if the witness will directly or indirectly benefit from the will. If there is a necessary interested witness, California validates the will, but there is a presumption that improper means were used by the interested witness to obtain the gift. A witness is necessary if without her there is only one other witness. If the interested witness overcome[sic] the presumption, she will take under

the will. If, however, the presumption cannot be overcome, then she will only get to take her intestate share of the estate, and no more.

Here, W was an interested witness because she is taking under the will. Further, W was necessary to make the will valid because without her signature, there was only one other witness. Therefore, a presumption of improper influence arises. However, W should be able to easily overcome this presumption. W, being the wife of H, is a natural object of H's bounty. Common sense would dictate that W would receive a substantial share of H's estate. If W can provide some evidence that they had a good relationship, and that he had told her she would get a good share of her estate, that should be enough to overcome the presumption.

Intestate Share

Even if W is unable to overcome the presumption, W is entitled only to her intestate share. However, W's intestate share would be a sizeable share. W would be entitled to H's ½ of the community property and quasi-community property. Community property is that property acquired during marriage while the parties were domiciled in California. Here, this would include all the property acquired through the earnings of H and W and the rents, issues, and profits therefrom, since 1998 when the parties were domiciled in California through H's death in 2003.

W would also be entitled to ½ of the quasi-community property. Quasi-community property is property that was acquired while the parties were domiciled elsewhere that would have been community property had the parties been domiciled in California. Therefore, all property acquired during the marriage between 1996 and 1998 would be quasi-community property. Upon the acquiring spouse's death, that property would go to the surviving spouse. Because W would already own ½ of the community and quasi-community property, W would end up with all of the community and quasi-community property at the end.

Regarding H's separate property (sp), H has the power to dispose of all of his separate property as he sees fit. However, W, as H's surviving spouse, would be entitled to an intestate share of H's separate property if she cannot overcome the presumption. In California, if the decedent dies without any issue, then the sp goes all to the surviving spouse. If he dies with one issue or parents or issue of parents, then the surviving spouse gets ½ of H's sp. If the spouse dies with two or more issue (or issue of a predeceased issue), then the surviving spouse gets 1/3 of H's sp.

Here, H died with two issue surviving- Ann and Carl. Therefore, W's intestate share of H's sp would be 1/3 of all separate property.

Therefore, even if W is unable to overcome the presumption of improper influence, she still will be able to obtain quite a bit of property because of the intestate succession

laws.

In Other Claims

F's claim will be discussed below, as well as C's and A's claim. This is just to note that if all of these three claims fail, then W will take the entire estate of H, both sp and cp. However, if any of these claims do not fail, then W will not get to take the entire estate because the claimant will be entitled to whatever stake his or her claim had.

b. Ann's Claim

A's claim will be based on California's pretermitted child statute. A, a child of H, was left out of H's will. Under the pretermitted child statute, a child that is born or adopted after the will or codicil is executed, and is not mentioned in the will, will be able to receive an intestate share of the decedent's estate, unless the decedent made it clear in the will that a pretermitted child will not inherit, the child is being supported outside of the will, or the decedent has another child and leaves all or substantially all of his estate with the parent of that child.

Here, A's claim will fail because she was alive when H executed his will, and H did not include her in the will. The only exceptions to this rule are if the decedent thought the child is dead or did not know the child existed. Neither of these two are applicable here. H and A lived together in State X, so it is clear that H knew of A and did not think she was dead. A's claim for an intestate share will fail because she was not a pretermitted child.

c. Carl's Claim

C's claim will also be on the pretermitted child statute. Please see immediately above for a discussion on the statute. Here, C was a pretermitted child because he was adopted after H's will was executed. For an adopted child the time is when the child is adopted, not when the child was born. Therefore, unless one of the three exceptions applies, C will receive an intestate share.

First, there is nothing in the facts indicating that the H's will says he won't take. Second, there is nothing demonstrating that C is provided for outside of the will.

However, H does have one child surviving (A), and all or substantially all of the assets are being given to the parent of C, W. Under the third exception, C will not be able to receive an intestate share. C may argue that A is not a child of W. However, the statute says that if the decedent has one child, and the assets are given to the parent of the child claiming, then the exception applies. Here, because those two requirements are met, C will not be entitled to an intestate share. Note that if the statute said the other child living had to be the child of the parent receiving the assets, then the exception would not apply and C would receive an intestate share.

2. Fred's Claim

Fred (F)'s claim depends on whether there was a valid private express trust, and if so, whether the doctrine of cy pres even applies to this trust.

Valid Trust

A trust must have trust property, a trustee, beneficiaries, manifestation of intent by the testatory, creation, and a legal purpose.

Property

First, there is trust property because the will says the property will be 5% of H's estate.

Trustee

Second, there is no trustee named. While a trust must have a trustee, a trust will not fail for want of a trustee. Therefore, a court will appoint someone to be the trustee.

Beneficiary

Third, there is an issue as to whether there is a definite and ascertainable beneficiary. In a private express trust, there must be a definite and ascertainable beneficiary. From the face of the will, there is no beneficiary, and so this may be a problem for F. F will want to resort to other methods to prove it was him.

Integration nor incorporation by reference will not work because both require a writing or document, and there is no writing or document here.

However, F may be able to prove himself under the doctrine of facts of independent significance. The question here is: Would this fact have any independent significance other than the effect on the will? If the answer is yes, then parol evidence may be introduced and that fact will become part of the will. Here, F can make a good argument that whoever is fishing (or skiing) with H the most before his death is a fact that has independent significance outside the will. H will be fishing (or skiing) with this person because they like each other's company, a fact that is significant outside the will. Therefore, F should be allowed to introduce evidence that he was the beneficiary under this doctrine.

But note- if F is not really the beneficiary because he does not meet this requirement, then this trust will fail for lack of beneficiary (please see below, towards the

end).

Manifestation of Intent by Settlor

H, the settlor, clearly had the present intent to create a trust when he executed his will. The terms of the will, using words of direction directing the trustee to pay the beneficiary. Thus, there is sufficient intent.

Creation

A trust may be created either inter vivos or testamentary. A testamentary trust is a trust that is contained in a will. In order for a testamentary trust to be valid, the will must have been executed with the proper formalities.

Here, H has created a testamentary trust by placing the trust in the will to take effect upon H's death. As discussed above, the will was properly executed under California's will statute. Therefore, there was sufficient creation.

Legal Purpose

A trust must serve a lawful purpose. Here, there is a lawful purpose in giving a beneficiary an installment of money over a period of ten years. Nothing in this trust is unlawful.

Therefore, all of the requirements for a trust have been met and there is a valid trust.

Cy Pre[s]?

The trust's terms specially said that the payments would go to whoever was skiing with H the most during the last 12 months of his life. F fished with H the most during the last 12 months of H's life, and now seeks to have the doctrine of cy pre[s] apply.

The doctrine of cy pres applies to charitable trust, when the settlor had a general charitable intent, but the mechanism for expressing the intent has been frustrated. If this is the case, the court will order a new mechanism to express the settlor's charitable intent.

Charitable Trust?

A charitable trust is a trust created for the benefit of society, for such purposes as education, the arts, etc. It is very similar to a private express trust (requiring trust property, a trustee, a beneficiary, manifestation of intent, creation, and lawful purpose), but has two significant differences: first, the beneficiaries must be unascertainable, ie, a large class,

because the "real" beneficiary is considered the public. Second, cy pres only applies to charitable trusts, not to private express trusts. Note also that the Rule Against Perpetuities does not apply to a charitable trust either.

Here, the trust created is not a charitable trust for several reasons.

First, there was no general charitable intent. Nothing in the trust was to benefit education, etc. This lack of charitable intent is shown by the fact that the beneficiaries are not a large class. Rather, the beneficiary is one person. Therefore, this is too ascertainable to be a charitable trust.

Because this is not a charitable trust, the doctrine of cy pres will NOT apply because the doctrine does not apply to private express trusts. F will not get to share in the estate.

Trust Fails For Lack of Beneficiary

This trust will now fail for lack of a beneficiary. F does not meet the terms of the trust, and neither does anyone else. Therefore, there is no beneficiary. When a trust fails for lack of beneficiary, a resulting trust in favor of the settlor or settlor's heirs occurs. A resulting trust is an implied in fact trust based on the presumed intent of the parties. Therefore, the 5% of the estate will result back to H's heirs- which is only W under the will. W therefore, will end up taking H's entire estate under the fact pattern presented in this question.

THURSDAY MORNING
JULY 29, 2004

California Bar Examination

Answer all three questions.
Time allotted: three hours

Your answer should demonstrate your ability to analyze the facts in question, to tell the difference between material and immaterial facts, and to discern the points of law and fact upon which the case turns. Your answer should show that you know and understand the pertinent principles and theories of law, their qualifications and limitations, and their relationships to each other.

Your answer should evidence your ability to apply law to the given facts and to reason in a logical, lawyer-like manner from the premises you adopt to a sound conclusion. Do not merely show that you remember legal principles. Instead, try to demonstrate your proficiency in using and applying them.

If your answer contains only a statement of your conclusions, you will receive little credit. State fully the reasons that support your conclusions, and discuss all points thoroughly.

Your answer should be complete, but you should not volunteer information or discuss legal doctrines which are not pertinent to the solution of the problem.

Unless a question expressly asks you to use California law, you should answer according to legal theories and principles of general application.

ESSAY QUESTIONS AND SELECTED ANSWERS

FEBRUARY 2006 CALIFORNIA BAR EXAMINATION

This web publication contains the six essay questions from the February 2006 California Bar Examination and two selected answers to each question.

The answers received high grades and were written by applicants who passed the examination. Minor corrections were made for ease in reading. The answers are reproduced here with the consent of their authors.

Question 2

Tim and Anna were married for ten years. In 2000, their marriage was legally dissolved. For several months following the dissolution, Tim and Anna attempted to reconcile but ultimately failed to do so.

In 2001, after reconciliation attempts failed, Tim executed a valid will leaving "all my property to my best friend, Anna." Later that year, Fred was born to Anna out of wedlock. Tim was Fred's father, but Anna did not inform Tim of Fred's existence.

In 2002, Tim and Beth married. Two days before the wedding, Beth executed a prenuptial agreement waiving all rights to Tim's estate. Beth was not represented by counsel when she executed the prenuptial agreement.

In 2003, Sarah was born to Tim and Beth.

In 2004, Tim died. His estate consists of his share of a $400,000 house owned with Beth as community property, plus $90,000 worth of separate property.

Tim's 2001 will has been admitted to probate. Beth, Sarah, Fred and Anna have each claimed shares of Tim's estate.

How should the estate be distributed? Discuss.

Answer according to California law.

Answer A to Question 2

Question Two

I. Existence of a Valid Will

The first issue is whether, upon his death, Tim dies testate leaving a valid will able to be probated. The facts indicate that upon his death in 2004, Tim died[sic]. In 2001, Tim executed a valid will which has now been admitted to probate. As such, the will will be presumed to be a valid statement of Tim's testamentary intent; he will be presumed to have had testamentary capacity when he made it, knowing the natural objects of his bounty and the status of his personal possessions, and will be presumed to have complied with the requisite legal formalities.

As such, the next issue is to determine whether, under the terms of his will as executed, any of those individuals having an interest in Tim's estate, which include Beth, Sarah, Fred and Anna, will take an inheritance under the terms of the will.

II. Distribution of Tim's Estate Under the Will

Upon death, a testator may devise and bequest his one-half share of community property and the entirety of his separate property. Tim's 2001 will, as probated, leaves all of his property to Anna. The issue is whether this will prevent Beth, Sarah, or Fred from taking any portion of Tim's estate. Each individual and the will's impact upon their ability to inherit from Tim's estate and[,] if so, the extent of their portion, will be discussed in turn.

A. Beth

On the face of the will, Beth receives nothing from Tim's estate, however Beth has claimed a share. Two key issues will impact whether Beth is entitled to a portion of Tim's estate despite the the [sic] terms of the will, 1) whether she may claim the status of a pretermitted spouse, and 2) whether her waiver of inheritance rights prior to marriage was an effective relinquishment of her portion of Tim's estate.

1) Pretermitted Spouse

Under CA law, if a testator dies with a validly executed will that makes no provision for a spouse whom he married after he executed the will, a presumption is raised that the testator did not intend to leave the spouse out of the will but merely forgot to execute an updated will.

This presumption can be rebutted by showing that the will on its face makes it clear that the testator did not intend to provide for the spouse, or by demonstrating that the testator made alternative, non-testamentary provisions for the spouse, i.e. by purchasing life insurance or an annuity or making an inter vivos gift. Because the terms of Tim's will are so simple,

it cannot be shown on its face that Tim intended to leave Beth out. In addition, Tim does not seem to have made alternative arrangements for Beth via gift or the provision of insurance. The only such evidence would be the fact that the house Tim and Beth shared was community property, so perhaps Tim thought the house would go to Beth, and that would be sufficient; however, the terms of his will contradict this, as he indicated all of his property would go to Anna.

The final way to rebut the presumption of Beth's status as a pretermitted spouse is to show that she validly executed a waiver of her rights to inherit from Tim's estate, discussed below.

2) The Prenuptial Waiver

The issue is whether Beth's waiver of all rights to Tim's estate is valid. If valid, then Beth may make no claim on Tim's estate. In order for such a waiver to be valid, several requirements must be met. First, the waiver must have been voluntary and not due to coercion. The facts indicate that Beth signed the waiver 2 days prior to marrying Tim, which may raise an inference that she did not have sufficient time to consider the waiver and[,] as a result, it wasn't truly voluntary.

Second, the waiver must have been executed only after Beth was fully informed of Tim's wealth and the extent of his estate. If Beth had no such knowledge, the waiver will be ineffective.

Third, Beth needed to have been represented by independent legal counsel. She was not so represented when she signed the agreement, and therefore the waiver will be presumed invalid. Unless Tim's estate can overcome the presumption of the invalidity of Beth's waiver due to the factors discussed above, she will be treated as a pretermitted spouse. As such, she will take her intestate share and will be entitled to Tim's half of the community property (the house) and one-third of his separate property, because he left 2 or more living issue, Sarah and Fred.

B. Fred

The issue is whether Fred will be able to claim status as a pretermitted child because he was born after the will, and thus if he will be entitled to a share of Tim's estate despite the terms of the will.

Because Fred was born in 2001, but after the will was executed, he will claim to have been unintentionally left out of Tim's testamentary provision and thus pretermitted. Fred will argue that because the terms of the will do not state on their face that he was left out on purpose, and because he has received no other gift or devise in lieu of an inheritance, that he is pretermitted.

Tim's estate may argue that because Tim's will left everything to Anna, Fred's mother, that Tim did not intend to make a separate provision for Fred. However[,] this argument will fail because Tim did not know that Fred existed, and thus the bequest to Anna could not have been meant to also care for Fred.

CA courts presume that when a man dies without knowledge of a child, that has [sic] the man known of the child that he would have provided for the child. As such, and because Fred will be considered a pretermitted heir, Fred will be entitled to a one-third share of Tim's separate property, equal to $30,000.

C. Sarah

Sarah will make substantially the same arguments as Fred, in claiming that she too is a pretermitted child. Of course, Tim knew of Sarah, but she can also rebut the presumptions against pretermission as Fred was able to do, and because Tim seems to have made no other provision for her, she will be considered a pretermitted child and will take a one-third share of Tim's separate property, $30,000.

D. Anna

Upon divorce, any will that has already been executed that leaves everything to the ex[-]spouse is considered invalid. However, in this case, Tim's will was executed both after legal dissolution of him [sic] and Anna's marriage and even after attempts to reconcile. Thus, Anna being an ex-spouse will not result in an invalidation of the will.

The CA courts hold a testator's intent to be the key to whether a will makes a valid distribution of the estate. Because the will was validly executed, Anna is entitled to inherit under it. However, because of the claims of Beth, Fred, and Sarah, there won't be anything left for her.

III. Intestate Succession

Under the contingency that the court holds the will invalid as no longer demonstrating Tim's intent, his estate will pass via intestacy. In that case, once again Beth would get the house and $30,000 (⅓ SP), Fred ⅓ SP and Sarah ⅓ SP, and Anna nothing.

Answer B to Question 2

2)

In Re Estate Of Tim (T)

Tim (T) died in 2004 and left various individuals who are all claiming a stake in Tim's estate.

Requirements for a Will

A will requires that the testator sign a will with present testamentary intent in the presence of two witnesses at the same time and that both witnesses understand the significance of testator's act. Here the facts state that the will was valid, so it is presumed that all formalities were met.

Beth

Beth was T's wife. Therefore, she is entitled to a ½ interest in all of T's community property. Additionally, Beth may argue that she is entitled to T's estate as an omitted spouse.

Omitted Spouse

A spouse that is not mentioned in a will is entitled to an intestate share of a testator's estate if the marriage began after the execution of the will, unless there is (1) a valid prenuptial agreement, (2) the spouse was given property outside of the will in lieu of a disposition in the testator's will or if (3) the wife was specifically excluded from the will. T and B were married after T executed his will, as the will in probate was executed in 2001 and the marriage of T and B was in 2002. Additionally, there was no disposition outside of the will in lieu of a devise in the will and there was no reference to excluding any spouse of B in particular in T's will. However, whether the prenuptial agreement was valid is in question.

Prenuptial Agreement

A will argue that the prenuptial agreement was not effective because she was not represented by a lawyer. A prenuptial agreement is valid if there is a writing signed by the testator and the spouse was represented by counsel at the time that the agreement was signed. However, there is no need for separate counsel if the spouse knew of the extent of testator's property at the time of signing the will and she specifically was [sic] waived the right to counsel in writing.

Here the[re] was no representation by counsel. Additionally, there are no facts that indicate that Beth was advised to get separate counsel, waived her right to separate

counsel, or even knew of the extent of Tim's property. Nor did Beth waive the right to knowledge of Tim's property. Therefore, it cannot be said that Beth validly waived her right to counsel or knowingly and voluntarily entered into the prenuptial agreement.

Although Anna will argue that the prenuptial agreement should have served as evidence of T's intent to disinherit B, such evidence should not be admissible because it is not probative of any of the exceptions to the omitted spouse provisions in California's intestacy statutes.

Because the prenuptial agreement was not valid, Beth is entitled to an intestate share of the estate.

Intestate Share of the Estate

If the court agrees that the prenuptial agreement was not effective, then the omitted spouse will receive an intestate share of Tim's estate. Under California's probate code, an [sic] spouse's intestate share is ½ of all community property and ⅓ of testator's separate property if the testator died with more than one issue. Here, Tim dies with two children. Although T did not know about Fred (his illegitimate son), if his will had been admitted to probate, Fred would have been able to collect his share under the will along with Sarah, T's legitimate daughter.

Conclusion

Therefore, if the prenuptial agreement was found to be invalid, Beth should claim ⅓ of T's separate property estate and the testator's ½ community property, or all of the $400,000 of T's community property share in the house and $30,000 of his separate property. If this is so, all other gifts under the will will be abated in this amount. If the prenuptial agreement is found to be valid, however, Beth will be entitled to nothing.

Sarah

Sarah was a child who was left out of the will and was born after the execution of the will. Therefore, Sarah will attempt to invoke the omitted child rule under the probate code.

Omitted Children

A child may claim to be a pretermitted child if a will omitted them from its face and if the child was born after the last executed will or codicil. An omitted child may collect his or her intestate share, unless she was left property outside of the will in lieu of the a [sic] devise, unless there was some intent in the will to disinherit the child or unless there was at least one child in existence at the time of the will's execution and the testator gave substantially all of his assets to the pretermitted child's parent.

Here, Sarah was born after execution of the 2001 will and was not included in the will. Additionally, she was no[t] disinherited in the will, nor was she given anything outside of the will in lieu of a devise in the will. Finally, there was no child in existence at the time of Tim's execution of his will. Even if A argues that the child was in gestation at the time of execution and, therefore, is a Prometheus child, this argument is still flawed because Tim did not leave substantial property to Sarah's parent under the will.

Therefore, Sarah should collect an intestate share under the will.

Intestate Share

As stated above, a spouse should claim ⅓ of a [sic] intestate's separate property estate under intestacy if the testator had 2 or more children or issue of those children at the time of his death. Under Section 240 of the probate code all property in intestacy shall pass to the next living generation, which is the generation of Sarah and Fred. At that point the property should be divided equally among all issue then living and not living. Because both Fred and Sarah are living, both would collect ½ of the ⅔ remaining separate property estate under intestacy.

Conclusion

Therefore, Sarah should also receive ⅓ of Tim's separate property estate, which should be ⅓ of the $90,000, or $30,000.

Fred

Fred may also claim to be an omitted child because he was left out of the will and was born, according to the facts, later in the same year as the execution of Tim's will. Fred was not included in Tim's [will] or disinherited in it, nor was he provided any property outside of the will in lieu of the property in the will.

However, although A may argue that although substantially all of Tim's property was left to Fred's mother, Anna, at the time of the disposition of the will, this exception to the rule for omitted children will not apply because Tim did not have at least one child in existence at the time of executing the will. Because this is so, the third exception, which excludes a child as an omitted child if the testator has at least one child at the time of his or her will's execution and left substantial property under in [sic] his or her will to the child's parent, does not apply.

Therefore, Fred is entitled to an intestate share of the property as an omitted child.

Conclusion

If it is shown that Fred was the child of Tim then Fred should collect $30,000 of Tim's estate as an omitted child.

Anna

Anna was Tim's ex-wife, and she claims a stake [in] T's will. Anna was left the residuary of T's estate. A residuary is a devise that leaves all property that has not otherwise been devised under the will or been taken through the omitted children and spouse provisions in the probate code.

Anna's take under the will depends on the distributions to Beth and to Fred. If the prenuptial agreement with Beth was valid, Anna would collect T's ½ interest in the house and the $30,000 in separate property that would have gone to Beth under the intestacy statutes. Additionally, Anna would collect Fred's $30,000 if he could not collect under the intestacy statutes.

However, Anna's distribution under the will is abated in the amount that Beth, Fred and Sarah collect under the will. If all three collect under the will, there will be nothing in the estate left to probate, [and] all of Anna's distributions under the residuary clause of T's will will be reduced to nothing[.]

Dissolving Of Will Terms At Divorce

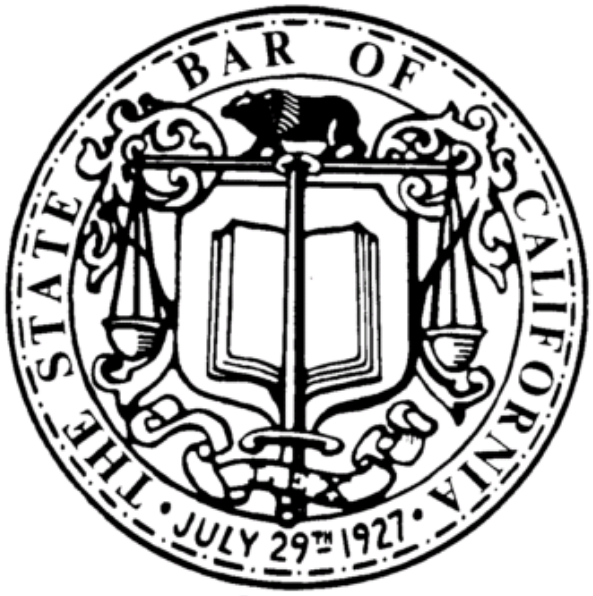
Although normally provisions in a will dissolve at a divorce, a will created after the finalization of the divorce to a spouse [does] not dissolve. The provisions in this will were executed after the divorce and name Anna as a friend, rather than a spouse. Therefore, the provisions did not dissolve as they were not in existence at the time of the divorce.

Community Property

A spouse is entitled to ½ of all of testator's community property. However, Anna was not the spouse of T at T's death. Therefore, there is no community, and, thus no community property.

Conclusion

Whether A collects under the will depends on whether the omitted child statute applies to Fred and the omitted spouse exception does not apply because of the prenuptial agreement with to [sic] Beth. If either the omitted spouse or child do not collect under the will, all property not taken by those persons should go to Anna as the residuary devisee.



California
Bar
Examination

Essay Questions and Selected Answers

July 2006

Question 6

In 2003, Tom, a patient at Happy Home, a charitable convalescent hospital that specializes in caring for the disabled elderly, asked Lilly, his personal attendant, to help him execute his typewritten will. Tom suffered from severe tremors and had difficulty signing his name. In the presence of one other attendant, Tom directed Lilly to sign his name and to date "my will." She did so and dated the document. At Tom's request, Lilly and the other attendant, in the presence of each other, then signed their names as witnesses.

The 2003 document stated "I give $100,000 to my niece, Nan. And, because Happy Home does such important work for the aged who are disabled, I give the residue of my estate in trust to Happy Home for the continued care of the disabled elderly. Lilly to act as Trustee."

In 2004, Tom, believing he needed to do more for the disabled elderly, asked Lilly to type a new will and told her he would take care of executing it. She typed the will, including in it the terms Tom dictated. He then asked Lilly to send two attendants into his room to act as witnesses. After the first of the attendants arrived and was present, Tom explained the purpose of the document and then signed his name at the end of the document. The first attendant then signed her name as a witness and left the room. Immediately thereafter the second attendant came into Tom's room and quickly signed the document as a witness. Lilly was not present when Tom or the attendants signed their names. The 2004 document stated "I revoke all prior wills and I give my entire estate to Happy Home in trust for the continued care of the disabled elderly. Lilly to act as Trustee."

In 2005, Tom died, leaving an estate worth one million dollars.

At the time of Tom's death there were only two convalescent hospitals in the county where Tom lived, Happy Home and Sunnyside. A few days after Tom's death, Happy Home went out of business. Sunnyside, also a charitable convalescent hospital, provides care for disabled persons of all ages.

Sunnyside has petitioned the court to substitute Sunnyside as the beneficiary of Tom's estate.

1. What rights, if any, does Nan have in Tom's estate? Discuss. Answer according to California law.

2. How should the court rule on Sunnyside's request to substitute Sunnyside for Happy Home as the beneficiary of Tom's will? Discuss.

Answer A to Question 6

6)

Question 6

1) What right does Nan ("N") have in Tom's ("Ts") estate?

The first issue is whether N has any rights in T's estate. N was named as a beneficiary under T's first putative will but was not named as a beneficiary under T's second putative will. The issue is thus whether the first will was valid in the first instance, and, if so, whether the second will validly revoked the first will.

Will #1

Formalities of a Formal, Attested Will

Will 1 was a typewritten will. Thus, Will 1 would have to conform to the requirements necessary for a formal, attested will.

Under California law, a formal attested will: 1) must be signed by the testator, by someone at his direction and in his presence, or by his conservator: 2) must be signed in the presence of two disinterested witnesses who are both present at the same time; 3) must be dated; and 4) must be signed by the two witnesses. Although the witnesses need not know the contents of the will, they must know that they are witnessing the execution of the testator's will.

Signature

Here, T, as a consequence of his disability, asked Lilly ("L") to help him execute his will. Because T had severe tremors and had difficulty signing his name, he asked L to sign for him. Given that L signed the will in T's presence and at his direction, this would satisfy the first condition stated above (i.e., that the testator sign the will or have another person sign the will at his direction).

Attestation

The next issue is whether the will was validly attested to by two disinterested witnesses. Here, one other attendant, in addition to L, was present when the will was signed. The issue is whether L, who signed the will at T's direction, could be considered a disinterested witness. On one hand, it might be argued that L was simply taking T's place, as she signed the will for T at his direction. In that sense, L would not seem to be a disinterested witness who could properly attest to the signing of the will. On the other hand, however[,] because L was simply signing the will for T, it might be argued that she could serve in two

capacities: as a witness and as T's attendant. Under this view, which is the one adopted here, L was a proper witness. Thus, because the will was validly witnessed by two disinterested witnesses who were both present when the will was signed, the second requirement stated above would also be met. Additionally, because both L and the other attendant signed the will before T's death, this would meet the fourth requirement stated above. Consequently, on these facts, it seems that Will 1 was a validly executed, formal will.

Disinterested Witness

Assuming, as stated above, that L was a proper witness, the next issue is whether she would truly be considered disinterested, as she was named as the trustee under the terms of Will 1.

The general rule is that a beneficiary cannot be considered as a disinterested witness for purpose of attesting to a will. However, if a witness is deemed to be interested, this does not affect the validity of the will. Rather, this simply means that the interested witness only takes that share of the estate that he would be entitled to in the absence of the will (i.e., his intestate share).

Here, L was named as the trustee of the trust to Happy Home ("HH"). Thus, it might be argued that L was an interested witness. Therefore, under this reasoning it might be argued that the will was not validly attested to. However, under the California law, a trustee of a trust is not considered a beneficiary under a will. Rather, the trustee is a fiduciary who does not take a gift under the will in her personal capacity. Thus, L would not be considered an interested witness, and she could thus properly witness the execution of T's first will.

Effect of Will 2 on Will 1

Before considering whether N would have any interest in T's estate, we must first consider the effect of T's second putative will ("Will 2") on Will 1, which, as discussed above, was likely a valid will.

Revocation by Subsequent Instrument

A testator may revoke his will be executing a subsequent will or codicil, which is a testamentary document that amends, revokes, or revises a prior will. To revoke a prior will, the testator must show an intent to do so. Moreover, for a valid revocation to occur, the second testamentary document must also comport with the formalities stated above under the California Probate Code.

Here, Will 2 was also a typewritten will. Although T did not type the will himself, he directed L to do so. However, the first issue is whether this would be valid, given that L, rather than

T, typed the will. Because the facts state that L typed the will, including in it the terms T dictated, it is reasonable to assume that L typed the will in T's presence. This would be proper.

Attestation

The next issue is whether Will 2 was validly attested to by two disinterested witnesses. Here, L sent two attendants to T's room to act as witnesses. After the first attendant arrived, T explained that he was executing his will, and he signed the will in the presence of the first attendant only. The first witness signed her name before the second witness entered the room. This would be proper under California law, as the witnesses need not sign in each other's presence. However, because the second attendant was not present when T signed his will, the will would be invalid under California law, which requires both witnesses to be present when the testator signs his will. Additionally, when the second attendant signed T's will, she did so quickly and the facts suggest that she likely did not know what she was signing. Although, as stated above, a witness need not be aware of the terms of the testator's will, she must know that she is in fact witnessing the execution of a will. Because T did not explain this to the second attendant, it seems that this requirement would also be lacking.

In sum, Will 2 was not validly executed because: 1) the two witnesses were not both present when T signed the will; and 2) the second witness likely did not even know that what she was witnessing was actually T's will.

Effect

Because Will 2 was not validly executed, it did not legally revoke Will 1, which was validly executed. Thus, although T explicitly stated in Will 2 that he revoked all prior wills, this statement would not be given effect despite T's apparently contrary intent. Consequently, Will 1 would continue to exist and would be probated in accordance with its terms at T's death in 2005.

N's Gift Under Will 1

Under Will 1, T left N $100,000. This would be considered a general gift as it is simply a sum of money, which is fungible. This, this gift could be satisfied from any of the funds remaining in T's estate at his death. Given that T had one million dollars in his estate at his death, N would be entitled to the $100,000 devised to her in Will 1.

2) How should the court rule on Sunnyside's ("S") request to substitute S for HH as the beneficiary of T's will?

Under Will 1, T gave the residue of his estate in trust (all of his one million dollar estate less the $100,000 to N) to HH for the continued care of the disabled elderly. L was to act

as trustee of the trust.

Trust Principles

A trust is a fiduciary relationship with respect to property wherein one person (the trustee) holds the property (trust res) for the benefit of a person or group of persons (beneficiaries), arising out of a manifestation to create it for a legal purpose. A trust thus requires: 1) an intent by the person creating the trust (settlor) to create it for a valid purpose; 2) property (trust res); 3) beneficiaries; 4) a trustee; and 5) valid delivery of the trust res to the trustee. A settlor may create a trust inter vivos by making a declaration of trust or by effecting a transfer in trust. A settlor may also create a trust through the provisions of his will (a testamentary trust).

Here, T created the trust through the provisions of his will. Thus, T created a testamentary trust which was to take effect on his death. The trust had a res, the residue of T's estate. The trust also had beneficiaries, HH and the disabled elderly. The trust had a trustee, L. The Trust was created for a valid, legal purpose- to care for and help the elderly. And, T expressed the intent to create the trust and the trust res was validly delivered through the will upon T's death.

Charitable Trust

The next issue concerns the nature of the trust created in T's will.

A charitable trust is a trust that is created in order to benefit the public health and welfare. Because the trust benefits society, it does not have any readily ascertainable beneficiaries. In other words, unlike a private express trust, the settlor does not name specific individuals who are to benefit from the creation of the trust. Rather, all those persons who fall within the class described in the trust are to receive its benefits.

Here, in Will 1, T devised the residue of his estate to HH for the continued care of the disabled elderly. Because no specific beneficiaries are named, it might be argued that the beneficiaries are all of those disabled elderly persons who qualify for convalescent care. Thus, it seems that the trust to HH might be considered a charitable trust, especially since it serves the greater public good by providing for the aged.

Cy Pres

The next issue is the effect of HH's going out of business on the validity of the trust. Under the doctrine of cy pres (meaning, as near as possible), a court has the power to give effect to a charitable trust where it would otherwise fail as long as the court only has to change the mechanism of the trust as opposed to the beneficiaries of the trust. A court only has cy pres powers to give effect to charitable trust where the settlor has manifested a general

charitable intent as opposed to a specific charitable intent.

Here, S might argue that T had a general charitable intent, as his ultimate goal was to provide for the care of the disabled elderly. Thus, S would argue that the court could use its cy pres powers to carry out T's intent by simply substituting S for HH. On the other hand, however, it might be argued that T had the specific charitable intent of giving the benefits of the trust only to those elderly persons who were residents of HH. On this view, the court would not be able to amend the trust to give it effect because T's intent would only be to benefit those elderly persons residing in HH as opposed to all elderly persons residing in convalescent homes in the county where T lived. Because T likely knew that S was in existence when he executed his will, there were only two convalescent homes in the county, a court would likely find that T only intended to benefit those persons who resided in HH. Consequently, the court would not use its cy pres powers to deviate from T's intent. Therefore, a court would likely find that the charitable trust to HH failed, as HH was no longer in existence at the time T's will was probated. Consequently, the court would declare a resulting trust under which the trust res (consisting of the residue of T's estate) would be reconveyed to T's estate and would be distributed to her heirs. Thus, it seems likely that N, T's niece, would also receive her intestate share of the residue of T's estate in addition to the $100,000 general devise she already received under Will 1.

Answer B to Question 6

6)

Question 6

As discussed below, Nan will likely take $100,000 from Tom's estate.

Validity of 2003 Will

Tom's 2003 will was a typewritten, formal. As such, in order to be valid, it must be [sic] satisfy the requirements for an attested (or printed) will.

Capacity to Make a Will

Under California law, in order to make a will, the would-be testator must be (1) at least 18 years old; (2) be able to understand the scope of his or her estate; (3) be able to understand who it is the estate will be devised and (4) have intent to make a will. Here, Tom is in a convalescent elderly home, so he is clearly over 18 years of age. In addition, the fact that he was able to specify the gifts and devisees indicated he meets (2) and (3). Finally, Tom also apparently had the intent to make a will. Hence, Tom had the capacity to make a will in 2003.

Requirements for an Attested Will

An attested will must be (1) in writing, (2) signed by the testator or by someone in testator's presence at his/her direction; (3) signed or signature acknowledged in the presence of at least two witnesses; and (4) the witnesses must understand that they are witnessing the execution or acknowledgment of a will.

In writing. Here, the will was typewritten, so this requirement for an attested will was met.

Signed by the testator or at testator's direction. Here, while Tom had difficulty signing his name, he asked Lilly, his personal attendant, to help him execute the will. Because Tom directed Lilly to sign and date the document at his direction and in his presence, the will was validly signed.

Signed or Signature Acknowledged in the Simultaneous Presence of At Least Two Witnesses. In order to be valid, an attested will must either be signed, or the signature must be acknowledged by the testator, in the presence of at least two uninterested witnesses. Here, this requirement is met because both Lilly and the other attendant, in the presence of each other, served as witness to the signature at Tom's direction.

Understanding of Witnesses of Execution of Will. Finally, the witnesses must understand

that Tom was executing a will. Here, Lilly and the other attendant both heard Lilly to [sic] sign Tom's name and to date "my will." Accordingly, this requirement is also met.

Possibility of Lilly as Interested Witness

In order to be validly executed, an attested will must have the signatures of at least 2 uninterested witnesses, meaning witnesses who will not take under the will or otherwise have a stake in its outcome. Here, the 2003 document gives the residue of Tom's estate in trust to Happy Home with Lilly as trustee. A witness is not an interested witness if he or she receives legal title only in a role of fiduciary duty. Here, Lilly is tasked with serving as trustee for the trust, and accordingly is named only in her capacity as a fiduciary. However, arguably, to the extent Lilly is an employee of Happy Home, she may have an interest in the trust that goes beyond her fiduciary duty. Nevertheless, with the facts presented, there is nothing to raise such suspicion that Lilly could not serve as a fiduciary and remain an uninterested witness. Hence, Tom's 2003 will was validly executed with 2 uninterested witnesses.

Validity of 2004 Will

In 2004, Tom attempted to execute another attested will that would have revoked the 2003 will and, instead of giving $100,000 to Nan, would have given the entirety of Tom's estate to the Happy Home trust. Because it was an attested will, it needed to conform with the same requirements discussed above for the 2003 will.

Failure to Comply with Requirements of an Attested Will

There is no indication that Tom lost the legal capacity to make a will. In addition, the 2004 will [was] typed by Lilly at Tom's direction and was signed by Tom himself.

NOT signed in Simultaneous Presence of At Least Two Witnesses

However, the 2004 will was not validly executed because it was not signed before two witnesses who were simultaneously in each other's presence. Here, the first attendant signed as a witness after witnessing Tom's signature and left the room before the second witness came in to sign. In addition, the second attendant did not witness Tom's signature or an acknowledgment by Tom of his signature. Nor was Lilly was [sic] present during Tom's or the attendants' signatures. Hence, execution of the will did not meet the requirement that it be signed in the simultaneous presence of two witnesses. As a result, the 2004 will is invalid.

Lack of Awareness By 2nd Witness of Will

In addition, the second witness did not appear to understand that Tom was executing a will. While Tom asked Lilly to send two attendants into his room to act as witnesses, it is unclear whether Lilly explained to the witnesses that they were witnesses to the execution of a will. Here, while the first attendant understood that Tom was executing a will – since

Tom explained the purpose of the document – the second attendant did not receive that information and instead "quickly" signed the document and left. Accordingly, execution of the will also fails for this reason, and the 2004 will is invalid on this ground as well.

Effect of Failure to Execute 2004 Will

Because Tom failed to validly execute the 2004 will, the 2003 will stands because the revocation contained in the 2004 will was not valid. Accordingly, Tom's 2003 will would enter into probate, under which Nan would inherit $100,000.

Charitable Trust

Trust. A trust is a fiduciary relationship whereby the trustee holds legal title of the res (or trust property) for the benefit of others, who are the beneficiaries of the trust, for a valid and legal purpose. Here, Tom's will created a trust at his death (as opposed to an inter vivos trust, or trust created while Tom was still alive) to Happy Home for continued care of the disabled elderly.

A private express trust requires (1) a trustee, (2) a beneficiary, (3) the res (trust property), (4) intent by the settlor to create a trust ad (5) a legal purpose. By contrast, a charitable trust differs from a private express trust in that a charitable trust does not benefit anyone in particular personally but rather society at large. Here, Tom's trust complied with the above by bequeathing the residue in trust with Lilly as trustee for a legal purpose of assisting the disabled elderly.

Here, Tom's trust is given to Happy Home "for the continued care of the disabled elderly." Society generally benefits when the most disadvantaged of its members–including the disabled elderly – are cared for. Accordingly, even though the trust names Happy Home (and the elderly it cares for) as specific beneficiaries, the intent was to create a charitable trust that in fact benefits society at large.

Cy Pres

Cy pres is an equitable remedy which a court may invoke in order to effectuate the settlor's general charitable intent with a charitable trust. Under cy pres, which means "as close as possible," a court may modify the direct beneficiary or goal of the charitable trust, to substitute another as close to as possible in keeping with the original goal or beneficiary, if the settlor's original wishes are no longer possible. Here, Happy Home went out of business a few days after Tom's death, and Sunnyside is another charitable convalescent hospital, although Sunnyside benefits people of all ages. Accordingly, Tom's trust would otherwise fail since Happy Home is no longer in existence without the intervention of the court in granting cy pres in order to keep the trust alive.

General or Specific Charitable Intent

In order to apply cy pres, the court must determine– using both the intrinsic (i.e. the trust instrument) and extrinsic evidence–whether Tom had a general charitable intent in setting up the trust, or whether he had specific intent. If Tom had specific charitable intent only to benefit Happy Home or only to benefit the elderly disabled, then the court will not be allowed to substitute Sunnyside as the beneficiary and a resulting trust will be applied. On the other hand, if Tom had general charitable intent to benefit the disabled generally, then cy pres may be invoked to prevent the failure of the trust by substituting Sunnyside.

Here, Tom set up the trust "to Happy Home for the continued care of the disabled elderly." Taken alone, this arguably suggests a general charitable intent to benefit the continued care of the disabled elderly, since Tom did not specify that the trust was meant to benefit only Happy Home's disabled elderly residents. On the other hand, Tom did specify that the trust was to benefit the elderly while Sunnyside assists disabled persons of all ages. Nonetheless, Sunnyside is the only other convalescent hospital in the county where Tom lived, so it may very well be the closest thing to effectuate a general charitable intent, even if it was for the disabled elderly.

The foregoing is of course subject to other extrinsic evidence, such as remarks Tom may have made to others. But assuming Tom had a general charitable intent and Sunnyside is the next-best alternative to effectuate Tom's intent, the court will invoke cy pres to substitute Sunnyside for Happy Home.

ESSAY QUESTIONS AND SELECTED ANSWERS

FEBRUARY 2007 CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the February 2007 California Bar Examination and two selected answers to each question.

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Question 4

In 2001 Tom, a resident of California, executed a valid typewritten and witnessed will. At that time, Tom was married to Wynn. Tom also had two nephews, Norm, and Matt, who were the children of his deceased sister, Sue.

Tom's will made the following dispositions:

> Article 1: I leave $10,000 to my friend Frank.
> Article 2: I leave my shares in Beta Corp stock to my friend Frank.
> Article 3: I leave $80,000 to my sister Sue's issue.
> Article 4: I leave the residue of my estate to my wife.

The $10,000 figure in Article 1 was crossed out and $12,000 was handwritten in Tom's hand above the $10,000 figure. Next to the $12,000 Tom had handwritten, "Okay. 2/15/02."

In 2003 Tom and Wynn had a child, Cole.

In 2004, Matt died in a car accident. Matt was survived by his children, Lynn and Kim.

Tom died in 2005. Tom was survived by Wynn, Cole, Norm, Frank, and his grandnieces, Lynn and Kim. At the time of his death, Tom owned, as separate property, $500,000 in cash. He also had 100 shares of Beta Corp stock, titled in Tom's name, which he had purchased with his earnings while married to Wynn. The Beta stock was valued at $1.00 per share at the time of Tom's death.

What rights, if any, do Wynn, Cole, Norm, Frank, and his grandnieces Lynn and Kim have in Tom's estate? Discuss.

Answer according to California law.

Answer A to Question 4

4)

1. Separate v. Community Property

The distributions amongst Tom's heirs is [sic] going to be governed, at least in part, by the classification of his property at death as either being his separate or community property.

a. The Beta Stock

The 100 shares of Beta stock was [sic] titled in Tom's name alone, and typically creates a presumption that the stock was his separate property. However, the stock was purchased with his earnings while married to Wynn, which are [sic] community property. The 100 shares of Beta stock, therefore, are community property. Because Tom only has the power to devise his ½ portion of the community property, he can only devise ½ of the Beta stock shares, or 50 shares, to Frank.

b. The Cash

The $500,000 owned by Tom at the time of his death is labeled as his separate property in this fact pattern. There are no facts present that would indicate that the $500,000 should be considered community property. Therefore, Tom is free to devise his separate property as he sees fit.

2. Frank

The will, on its face as noted in 2002, leaves Frank $12,000 and all 100 shares of the Beta stock. As noted above, the 100 shares of Beta stock are community property and because Tom cannot give away Wynn's ½ interest in community property, the most he can give away is 50 shares of the stock. And, although Tom indicated a desire to devise all 100 shares, something he cannot do, the devise will be treated as if Tom devised only his ½ community property interest in the shares. Therefore, Frank will receive 50 shares of Beta stock. Note that although the Beta stock has a cash value, because it is a specific bequest, i.e. it identifies specific property, Frank will receive the actual shares and not their cash equivalent.

Frank's will in its original form provided for a $10,000 cash bequest to Frank, which he later attempted to increase in 2002. Typically, a testator can partially revoke even just a portion of a will. One of the methods by which a testator may accomplish this is by obliteration, or crossing out the portion of the will that he intends to revoke. However, a testator cannot increase a provision in a will without adhering to the required formalities, i.e., the signature of acknowledgment of the testator's signature in the presence of two uninterested witnesses at the same time, who also sign the will. And, although California recognizes a holographic will, which does not require a witness and requires that a testator sign the will and that the material terms be written in the testator's own handwriting, this attempted

increase will not qualify as a holographic will as there is no signature by Tom to correspond with the 2002 change. The increase is therefore invalid.

However, in this situation the doctrine of dependent relevant revocation (DRR) is applicable. DRR applies where a testator revokes his will or a provision of his will with the belief, although mistaken, that a subsequent bequest is valid. Here, it is clear that Tom believed that the increase from $10,000 to $12,000 was valid and there is nothing to indicate that Tom had any intent of revoking the $10,000 bequest. In applying DRR, courts should look to the true intent of the testator and, in this case, Frank should receive $10,000 from Tom's estate, in addition to the 50 shares mentioned above.

3. Sue's issue

The disposition of Tom's $80,000 bequest is determined based on the representation of those issue. Sue had two children, Norm and Matt. Prior to Tom's passing in 2005, Matt died leaving two children, Lynn and Kim. Norm, Lynn and Kim are all Sue's issue. However, the distribution of the $80,000 will not simply be split between the three of them. Norm, Lynn, and Kim are issues of different degree. When confronted with issues of different degree, the bequest must be distributed by representation and the representation is determined at the closest to the decedent that qualifies for the bequest. Here, Norm and Matt are closer in degree than Lynn and Kim, and Norm is still alive; therefore, the $80,000 bequest must be distributed at that level. Therefore 50%, or $40,000, will be distributed to Norm. The remaining 50%, or $40,000, will be split between Lynn and Kim, based on Matt's representation, and they each will therefore receive 25% of the total, or $20,000.

4. Cole

Cole is what is referred to as a "pretermitted heir", which means he was born after Tom executed all of his testamentary documents. The rule generally is that, unless there is an unequivocal expression that the testator intended to disinherit the child, the child is entitled to receive the share that he would have received had his father died intestate (without a will). If Tom had died intestate then Cole would have been entitled to ⅓ of Tom's separate property. However, there is an exception to the general rule for pretermitted heirs where the will leaves substantially all of the estate to his spouse who is the child's parent. Here, Tom left the residue of his estate to Wynn, his wife and the mother of Cole. Because, as discussed below, Wynn is entitled to $410,000 of his separate property, Cole is not entitled to any share as a pretermitted heir.

5. Wynn

Because Wynn was Tom's spouse at the time of his death, she is entitled to ½ of all community property, and Tom cannot devise her half, unless he put her to a "Widow's election" and she consented. In this case there are only two pieces of property, the 100 Beta shares and the $500,000. As discussed above, the 100 Beta shares were community property and Tom only had the power to devise his ½ interest. Therefore, ½ of the 100

shares that Tom attempted to devise to Frank are actually Wynn's and Tom could not devise that half to Frank. Wynn is therefore entitled to 50 shares of the Beta stock.

As for the $500,000, it is Tom's separate property and he can devise it as he wishes. The residuary clause of Tom's will provides that the residue of his estate passes to Wynn. In this case, the residue of his estate is $410,000 ($500,000 - $80,000 - $10,000), and it all goes to Wynn.

In Summary

Frank: $10,000 + 50 shares of Beta stock
Norm: $40,000
Lynn: $20,000
Kim: $20,000
Wynn: $410,000 + 50 shares of Beta stock
Cole: $0

Answer B to Question 4

Wynn

The first issue with Wynn is to determine the nature of the Beta Corp's stock.

California is a community property state; thus it is necessary to decide the nature of the assets of the parties. Community property (CP) is any property obtained by either of the spouses during marriage by their labor. Separate property (SP) is any property owned by a spouse before marriage, acquired after permanent separation or by gift, devise, or bequest.

The nature or characterization of the property depends on the source of the property, acts by the parties that would change its characterization and any statutory presumptions.

Here, the Beta stock was acquired by Tom using his earnings while married to Wynn. Since, earnings gained during the marriage come from the spouse labor and earnings during marriage are presumptively CP. Since, the earnings are CP anything purchased using these funds would also be CP; hence, the stocks purchased by Tom are CP. Since the stocks are CP, and there was no action by either party showing that they were not supposed to stay that way, the stocks would be ½ Tom's and ½ Wynn's.

Thus, Wynn would be entitled to ½ of the Beta Corp stock, which is 50 shares.

Residuary

The residuary is the remainder of the property of a testator that has not otherwise been disposed of in the will. Under Tom's will Wynn is entitled to the residuary, which, if all the gifts in Tom's will are valid, would be $410,000 of his separate property cash.

Cole

Cole was left nothing under the will and will have to claim as a pretermitted child.

Pretermitted Child

A pretermitted child is one who is born or adopted after all testamentary documents have been executed. If a child is pretermitted they may collect a share equal to that they would have received had there been no will, i.e. intestacy. However, a pretermitted child may be prevented from claiming a share if they were intentionally left out of the will as demonstrated on the face of the document, they were provided for outside of the testamentary documents, or the bulk of the testator's estate was left to the other parent of the pretermitted child.

Here, Cole would be considered pretermitted as Tom executed his will in 2001, and Cole

was not born until 2003. Since there is no mention of other documents it is presumed that the will was the last testamentary document. Thus, Cole is pretermitted because it was executed before he was born, meaning Cole could be entitled to an intestate share of Tom's SP.

However, it is necessary to look at whether the exceptions apply. There is no evidence that Tom intended to intentionally leave out or disinherit any future born children. Thus, Cole is not blocked under this exception. Further, there is no proof or mention of a child being cared for in any way outside the testamentary instrument. However, since Tom's will leaves his residuary to Wynn, Cole's other parent, Cole may not collect under pretermitted child. This is because the residue of Tom's estate equals the bulk of his estate and he left it to Wynn. The presumption is that Wynn will use those assets to care for Cole; thus, he does not need an intestate share.

Thus, Cole has no rights in Tom's estate.

Norm - Lynn - Kim

Tom's will left a gift of $80,000 to the issue of his sister Sue. The issue here is how those issue will take under the will. Where a testamentary document is silent on the issue of distribution among issue, than [sic] in California the distribution is made per capita.

Per Capita Distribution

Per capita means that assets are divided at the first generation where there is a living beneficiary and then split. The assets are split evenly between the number of living descendants at that level, and the number of deceased descendants who have issue.

Here, since the will merely stated to Sue's issue, it would go per capita. Thus, it would split at the first generation with a live beneficiary, which is Norm. Since Norm is alive it will split evenly between him and Matt, his deceased brother, who left 2 children. This means that Norm will get ½ of the $80,000 gift, equal to $40,000 and the other half will go to Matt's issue.

Kim and Lynn will take per capita representation, meaning they will take their father's share in his place and split it equally among those at that level of descent. Since there is only Lynn and Kim each will receive ½ or $20,000.

Frank

Frank is Tom's friend who is to take $10,000 and Tom's shares in Beta Corp under Tom's will.

$10,000

Under the original will Tom left Frank $10,000; this amount was later crossed out and changed, raising the issue of cancellation.

Cancellation - Interlineation

Cancellation is where a provision of the will is crossed out of the will. Where there is writing above or between the lines and occurs with a cancellation, there is interlineation. Here, Tom has crossed out the $10,000 amount and written above it $12,000; thus there has been a cancellation of the $10,000 gift and interlineation of $12,000. Since there is a cancellation there is a question of whether the gift is still valid or not. To determine what if anything Frank gets there is a need to discover if the change is valid.

Holographic Codicil

A holographic change may be made if the material terms are in the writing of the testator and so is the beneficiary name. Here, Tom has crossed out the amount of $10,000 and in his own handwriting changed the amount to $12,000. However, Tom did not write out Frank's name in his own handwriting as well. Since Tom failed to put material provisions and person's name in writing, it is irrelevant that he wrote okay and dated it. It may show Tom's intent but does not meet the requirements for a valid holograph. Thus, the change to $12,000 fails. Frank will try to keep his gift using Dependant Relative Relocation.

Dependant Relative Relocation (DRR)

Here, a testator mistakenly revokes a will or gift under the will under a mistaken belief that another testamentary disposition would be valid. Further, the testator would not have revoked the first disposition but for the mistaken belief.

Here, Tom believed that by crossing out the amount $10,000 and writing $12,000 he would be validly changing the amount of the gift to Frank. This is demonstrated through the fact that Tom went so far as to write okay and date it. Thus, Tom obviously intended for Frank to receive a gift under the will, and would not have revoked the $10,000 if he had not thought that the change to $12,000 would be valid. Further, since the amount was an increase rather than decrease DRR may be applied to effect [sic] testator's intent. Here, since it is obvious Tom wanted Frank to receive at least $10,000, DRR will be applied to save the gift.

Beta Corp Stock

As mentioned with Wynn, Frank would only be entitled to those shares of stock that belonged to Tom. Since the stocks were determined to be CP and be ½ Wynn's and ½ Tom's, Frank could only collect 50 shares of stock or ½ of the total.

Frank is entitled to the ½ because Tom is able to pass by devise his ½ CP to anyone he

wants. Since the will said “my shares of Beta Corp to Frank” than [sic] Frank receives them. Further, by stating “my shares” in Beta Corp, Tom was only giving Frank the right to claim what belonged to Tom; meaning that Tom was only giving Frank a claim to his ½ CP interest in the stocks, and not attempting to give away Wynn’s ½ CP interest. (Thus, no widow’s election.)

In conclusion, Wynn has a right to ½ of the Beta Corp stock as CP and $410,000. Cole has no rights as Wynn received that bulk of the estate. Norm has a right to $40,000, Kim and Lynn each have a right to $20,000 and Frank has a right to $10,000 & ½ of Beta Corp stock (i.e. 50 shares).

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CALIFORNIA BAR EXAMINATION

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Question 4

In 2001, Wilma, an elderly widow with full mental capacity, put $1,000,000 into a trust (Trust). The Trust instrument named Wilma's church (Church) as the beneficiary. Although the Trust instrument did not name a trustee, its terms recited that the trustee has broad powers of administration for the benefit of the beneficiary.

In 2002, Wilma's sister, Sis, began paying a great deal of attention to Wilma, preventing any other friends or relatives from visiting Wilma. In 2003, Wilma reluctantly executed a properly witnessed will leaving her entire estate to Sis. Following the execution of the will, Wilma and Sis began to develop a genuine fondness for each other, engaging in social events frequently and becoming close friends. In 2005 Wilma wrote a note to herself: "Am glad Sis will benefit from my estate."

In 2007, Wilma named Sis as trustee of the Trust, which was when Sis found out for the first time about the $1,000,000 in the Trust. Without telling Wilma, Sis wrote across the Trust instrument, "This Trust is revoked," signing her name as trustee.

Shortly thereafter, Wilma died, survived by her daughter, Dora, who had not spoken to Wilma for twenty years, and by Sis.

Church claims that the Trust is valid and remains in effect. Sis and Dora each claim that each is entitled to Wilma's entire estate.

1. What arguments should Church make in support of its claim, and what is the likely result? Discuss.

2. What arguments should Sis and Dora make in support of their respective claims, and what is the likely result? Discuss.

Answer question number 2 according to California law.

Answer A to Question 4

1. What arguments should Church make in support of its claim?

A. Attempted creation of the trust

A private express trust is created when the following elements are met: (1) a settlor with capacity, (2) intent on the part of the settlor to create a trust, (3) a trust res, (4) delivery of the trust res into the trust, (5) a trustee, (6) an ascertainable beneficiary, and (7) a legal trust purpose. In this case, each of these elements have been met, and Wilma successfully created a valid inter vivos express trust.

(1) The facts state that Wilma had full mental capacity.

(2) The facts indicate that a trust instrument was created, which is evidence that Wilma intended to create a trust, and not some other type of instrument or conveyance.

(3) The res here is the $1m that Wilma put in the trust.

(4) According to the facts, Wilma put the $1m into the trust, so the delivery element is satisfied.

(5) The trust instrument here did not name a trustee. However, courts will not allow an otherwise valid trust to fail for want of a trustee. Rather, courts will appoint a trustee. So, notwithstanding the lack of a trustee, the trust was validly created. In this case, the lack of a trustee was cured later by Wilma, when she named Sis as the trustee in 2007. So, at the time of Church's assertion that the trust is valid and in effect, there is a trustee and the court need not appoint one. (However, given Sis's conduct in attempting to revoke the trust, which is likely a violation of her fiduciary duty as trustee, the Church should consider moving the court to dismiss Sis as trustee and appoint a new trustee.)

(6) The beneficiary in this case is Church. Beneficiaries can be natural persons, corporations, or other organizations. So, Church is a valid beneficiary. Because the beneficiary is Church, it can argue that the trust set up by Wilma is a charitable trust. Charitable trusts have as their purpose the specific or general charitable intent to benefit some social cause. Religion is considered a legitimate purpose of a charitable trust. Thus, this trust can be considered a valid trust.

(7) There is no illegal or otherwise improper purpose for Wilma's trust, so this element is satisfied.

B. Attempted revocation of the trust

Inter vivos trusts are revocable unless otherwise provided. The facts do not state whether the trust instrument had a provision making it irrevocable, so it is assumed that the trust is revocable.

A trust cannot unilaterally be revoked by the trustee. Typically, only the settlor (if she is alive and has mental capacity) can revoke an inter vivos trust. In some circumstances, a trustee and the beneficiaries may petition the court to terminate (or modify) a trust, but no such circumstances exist here. Thus, Sis's attempt to revoke the trust unilaterally, without telling Wilma and without involving the court, by writing across the instrument "This Trust is revoked," was ineffective. The trust therefore remains in effect.

Had Wilma written across the Trust instrument "This Trust is revoked," it might have operated as a valid revocation by physical act. However, such a revocation must be done by the settlor or by someone at the direction of the settlor and in her presence, which is not what happened here.

C. Survival of the trust after Wilma's death

Sis might argue that the trust should pass to her under Wilma's will, which left her the entire estate. However, there are no facts to suggest that Wilma only intended the trust to continue for her lifetime. Rather, the creation of the charitable trust by Wilma is assumed to be a valid will substitute, which disposes of the settlor's property outside of probate.

2. What arguments should Sis and Dora make in support of their respective claims?

A. Sis's Arguments

For Sis to succeed in arguing that she is entitled to Wilma's estate under the terms of her will, she must establish that the will is valid. A valid will requires (1) a testator with capacity, (2) testamentary intent, and (3) valid compliance with the applicable formalities.

(1) Capacity: To have sufficient capacity to execute a will, a testator must (1) know the nature and extent of her property, (2) understand the natural objects of her bounty (i.e., her relatives and friends), and (3) understand that she is making a will. The facts here state that in 2001 Wilma had full mental capacity. In 2003, when Wilma executed the will, it is presumed that she still had such capacity.

(2) Testamentary intent: Here, the facts state that Wilma executed a will, although she did so "reluctantly." Mere reluctance on the art of a testator is insufficient to defeat the existence of testamentary intent. However, if the

testator's intent was the product of undue influence, then true testamentary intent will not be found, and the will will be set aside to the extent of the undue influence. In this case, Dora will argue that Sis cannot take Wilma's estate under the will because she exerted undue influence on Wilma.

Undue Influence:

Undue influence exists when the testator was influenced to such a degree that her free will was subjugated. A prima facie case of undue influence is established by showing the following: (1) the testator had some sort of weakness (e.g., physical, mental, or financial) that made her susceptible to influence, (2) the person alleged to have exerted the influence had access to the testator and an opportunity to exert the influence, (3) there was active participation by the influencing person in the devise (the act by the person that gets them the gift), and (4) an unnatural result (i.e., a gift in the will that is not expected).

(1) In this case, there is no evidence that Wilma suffered from any particular weakness that made her susceptible to Sis's influence. She had capacity. She presumably was in good physical health, as she attended social events frequently. And she presumably was of comfortable means, as she was able to give away $1m to a charitable trust.

(2) Here, Sis did have access and opportunity to influence Wilma. She began "paying a great deal of attention" to her, and she prevented any other friends or relatives from visiting her. This element of the prima facie case is therefore established.

(3) It is unclear from the facts whether Sis actively participated in Wilma's drafting of her will, or somehow suggested in some other way that Wilma leave her estate to her. Dora would need to present evidence on this point to succeed in challenging the will on the basis of undue influence.

(4) The result here is not unnatural. Wilma is survived only by Sis and her daughter Dora. However, Wilma had not spoken to Dora for twenty years. Wilma is a widow, and leaves no surviving spouse or domestic partner. The facts do not suggest that Wilma had any close non-relative friends to whom she might naturally leave part of her estate. Wilma had already provided generously for Church in the trust. Therefore, it is natural that she would leave her estate to her sister. Moreover, Sis can argue that the "naturalness" of the result is further proven by the fact that she and Wilma genuinely became close friends in the years following the execution of the will. This friendship is evidenced by the note that Wilma wrote in 2005, which stated that she was "glad Sis will benefit from my estate."

(3) Formalities: In this case, the facts state that Wilma "executed a properly witnessed will," so the last element is satisfied.

Because all of the elements of a valid will are present, and because it is not likely that Dora can prove that the gift to Sis of Wilma's entire estate was the product of undue influence, Sis will take Wilma's entire estate under the will.

B. Dora's arguments

1. Dora's rights if undue influence is found

If Dora can prove that the gift to Sis is the product of undue influence, the will will be set aside to the extent of that undue influence. If there is a residuary clause in the will, the gift to Sis will pass into it. If there is no residuary clause, then the gift to Sis – which in this case is the entire estate – will pass as if Wilma died intestate. Because Dora is Wilma's only other surviving relative, the estate would pass to her.

2. Dora's rights as an omitted child

In California, if a child is pretermitted, she has certain rights to take from her parent's estate. A pretermitted child is one who is born after a will and all other testamentary instruments have been executed, and who is not provided for in the instruments. In this case, however, Dora was already born when Wilma executed her will in 2003 and the Trust in 2001. So, Dora is not pretermitted. (Had she been pretermitted, Dora would have been entitled to claim her statutory share of the estate passing through the will, plus a statutory share of any revocable inter vivos trusts.)

California does not provide protection for omitted children. An omitted child is one who was born at the time a testamentary instrument is drafted, but not provided for in the instrument. Therefore, Dora does not have any rights to Wilma's estate by mere virtue of being omitted from Wilma's will.

Answer B to Question 4

1. Arguments Church should make in support of its claim

Whether a valid trust was formed

A trust is a fiduciary relationship relative to property, where a trustee holds legal title to such property (corpus) for the benefit of a beneficiary, and which arises from the settlor's manifested present intention to create such a trust for a valid legal purpose. In the case of a private express trust, the beneficiary must be an ascertainable person or group, while for a charitable trust the beneficiary must be society at large.

Corpus

The corpus of a trust must be a valid currently existing type of property, and may not be a mere expectancy [of] future profits or any other illusory property. In the case of a trust set up during the settlor's lifetime (inter vivos), a trust with a third person as a trustee will be under transfer in trust, with delivery of the property being actual, symbolic (some item representing ownership) or constructive (presenting the means to access the property, or, modernly, doing everything reasonably possible to put the trustee in possession, without raising suspicion of fraud or mistake).

In this case, the corpus existed and was validly delivered, because it was $1 million in money, which Wilma actually put into the trust.

Beneficiary

If the beneficiary is an ascertainable group or person, a private express trust may form. If an unascertainable group that is for the benefit of society in general, even if some individuals incidentally benefit, that is a charitable trust. For a charitable trust, the rule against perpetuities does not apply to invalidate the trust.

In this case, it could be argued that the church is an ascertainable, definite legal person, in which case Wilma may have formed a private express trust. It could alternatively be said that the real benefit is in the present and future members of the church, which advances a social interest in having religious institutions. In that case, it could be a charitable trust, and even though under the trust some people might take a benefit more than 21 years after a present life [is] in being, there is no rule against [a] perpetuities problem and the trust is valid. Therefore, there was a valid beneficiary.

Trustee

A trustee, who is appointed to administer the trust, is necessary for a trust; however, a trust instrument will not fail because a trustee is not named. In this case, even though Wilma never named a trustee, a court can appoint a trustee to fulfill the duties of a trustee, and the trust is not invalidated.

Resulting trust

A resulting trust is an implied in fact trust that occurs when a private express trust or charitable [trust] fails by means other than wrongdoing by the settlor. Under a resulting trust, the court-appointed resulting trustee's sole duty would be to convey the corpus back to the settlor or, if dead, her estate.

It might be argued against the church that Wilma created the trust in 2001, and did not appoint a trustee until 2007, that presumably the trust had no trustee for a full six years, during which there was no trustee. Therefore, it may be argued that during that time, the trust should have turned into a resulting trust. It might also be argued that in certain states, there is a statute of uses that creates a resulting trust when there is a passive trust of real estate property where the trustee has no active duties. It might [be] argued that, equitably, this principle should also apply to where the corpus is money, and that having no trustee for six years is equivalent to having a passive trustee, and that the money should have gone into a resulting trust.

However, because courts have explicitly stated that trusts do not fail for want of a trustee, the trust by Wilma will likely not fail.

Manifestation of intent

For there to be a valid trust, the settlor must have made a clear manifestation that she was delivering the property with the present intention of creating a trust. In this case, Wilma clearly showed her intent to do so. While she failed to name a trustee, she provided for there to be a trustee by naming his broad powers, and actually delivered the money into the trust. Finally, because Wilma, although elderly, had full mental capacity, there is no questioning that her ability to intend to create a trust was compromised. Therefore, Wilma clearly showed a showing of intent to create the trust, and it will be valid.

Legal purpose

Any purpose that is not illegal is allowed. In this case, Wilma clearly intended that the church and/or its members benefit in carrying out its activities on an ongoing basis, and there was nothing illegal about that. Therefore, she had a valid legal purpose.

Therefore, a valid trust was formed in 2001.

Termination of the trust

A trust may terminate by its own express terms. It may also terminate by the settlor's express revocation, where she has reserved the right to do so (in a majority of states). Finally, a trust may terminate by initiation of the beneficiaries, if all of them join and consent (any unborn remaindermen must be represented by an appointed guardian ad litem). If the settlor also joins in, the termination may proceed. If the settlor does not or has died, then the beneficiaries may only terminate if all material purposes of the trust have been fulfilled.

Revocation by express terms
Here, there is no indication that Wilma provided for the trust to have ended at any point. Therefore, it was not revoked.

Revocation by settlor
Here, Wilma did not expressly reserve her right to revoke. Even in the minority of states where the right is implied, she never exercised such right. Sis may argue that Wilma's later making a note that she was glad that Sis would benefit worked to impliedly revoke the trust, since it showed an intent that Sis benefit from her estate, this will likely not be able to show Wilma's intent to revoke. Therefore, she did not revoke the trust.

Revocation by beneficiaries
As shown above, Wilma did not consent or join in any acts to terminate the trust. Furthermore, under the facts neither the church nor its members did anything to suggest that it wanted to revoke the trust; to the contrary, the church is suing to show the validity of the trust. Therefore, the beneficiaries did not revoke.

Therefore, no revocation occurred.

Powers of the trustee
A trustee has the powers expressly granted her in the trust instrument, plus any implied powers necessary to carry out her duties, such as the powers to sell, lease, incur debts on property, and modernly, to borrow.

Here, as of 2007 Sis was named trustee of the trust. The trust instrument provided that the trustee had "broad powers" to administer the trust for the benefit of the beneficiary. It spoke nothing of trustee's power or authorization to evoke, which is not traditionally a power implied to the trustee. Therefore, Sis had no power to revoke the trust by canceling it. Therefore, it was not revoked by her acts.

Duties of trustee
Furthermore, a trustee has duties of care and loyalty to the beneficiary. Under the respective duties, she must act as a reasonably prudent person handling her own affairs, and in the best interests of the beneficiaries at all times.

When Sis attempted to revoke the trust, intending to cut out the beneficiaries, this was expressly against the trust, and breached her duty of care. Also, because she was the taker under Wilma's will, she also breached her duty of loyalty because her act would have benefited her.

Therefore, Sis acted improperly, and her act of revocation was not valid.

Conclusion
Therefore, the trust was valid and was not revoked, and the church has a claim to it.

2. Arguments Sis and Dora should make in support of their claims

Dora's arguments
I: capacity
II: insane delusion
III: undue influence
IV: pretermitted

Capacity
A testator has capacity to make a will if she is over 18, can understand extent of her property, knows the natural objects of her bounty (family members, etc.) and knows that she is executing a will. If a testator lacks capacity, the entire will will not be probated and the property passes through intestacy unless there is a former valid will.

Dora may argue that because Wilma was elderly and a lonely widow, she lacked the true capacity to make a will, and that as Wilma's sole issue, she should take the whole estate under intestacy. However, Wilma was over 18. She was of full mental capacity, and knew what her property consisted of. She knew who the natural objects of her bounty were, because presumably she knew of Sis and Wilma. And finally, she executed a properly witnessed will with no signs that she did not know what she was doing. Therefore, Dora's argument will fail.

Insane delusion
A provision in a will [can] be denied probate if 1) it was based in a false belief, 2) which was the product of a sick mind, 3) there was not even a scintilla of evidence to support the belief, and 4) the belief actually affects the will (shown by the provision in question).

Here, Dora may argue that Wilma may have had some sort of sick mind causing her to believe that she would devise all her estate to Sis and leave Dora out. However, there is no evidence to support that view. Wilma's will was based in a genuine belief in and factual close relationship with Sis that had developed. There is no indication of Wilma's sick mind. Finally, no false belief affected the will. Wilma and Sis got along well, engaged in social events together, and were close friends. Therefore, Dora's argument will fail.

Undue influence
There are three bases for undue influence: prima facie case, presumption, and CA statute.

Prima facie UI

If a person has access to a testator, the testator was of a susceptible trait, the person had a disposition to induce the testator and there was an unnatural result, there will be a prima facie case of undue influence, and the relevant affected provision will not be probated.

Here, Dora can show that Sis had access (indeed, sole access to Wilma, through her own prevention of others). Dora will emphasize that Sis acted wrongfully in paying an unnatural amount of attention to Wilma suddenly, and preventing others from accessing her. However, Sis will show that her interest in Wilma was legitimate, as shown by their growing fondness for each other. However, she cannot show that Wilma was particularly susceptible in any way. She was likely lonely, but she did not have outward signs of feebleness to subjugate her testamentary intent.

Sis may have had the disposition to induce Wilma to make a will in her favor, because she was with her all the time, but it will also be hard to show that she did anything to manipulate her into making the will. Additionally, she made the will soon after Sis began paying attention to her, and it happened to leave everything to her. Dora will argue these points; however, she cannot show that Sis actually did anything to induce the will, and the two became genuine friends. Furthermore, the note from 2005 shows that Wilma was genuinely pleased to have provided for Sis. Even if Sis had exercised a disposition to coerce a will, it would be difficult to imply that she did so with an extrinsic note showing testator's intent. Therefore, Dora will have a tough time proving this element. Her best case is likely to argue that the note was not written until 2005, and in 2003, at the time of the will's execution, a disposition was exercised, which would be enough to satisfy.

Finally, giving all of her property to Sis was not an unnatural result, though Dora will claim that cutting out a child is unnatural. Wilma had not spoken to Dora in twenty years, long before Sis's interference. Therefore, it was not unnatural to cut Dora out.

Therefore, the prima facie case fails.

Presumption UI

If a person is in a certain type of close relationship with the testator (in CA, any position where the testator reposes trust in the person), and there is a disposition to cause the devise and there is an unnatural result, there will be a presumption of undue influence, and the will will not be probated.

Here, Dora can clearly show that Wilma reposed her trust in Sis, since they were close friends and Wilma even appointed her trustee over the trust to the church. However, as discussed above it will be difficult to show disposition, and more so to show an unnatural result.

Therefore, this branch of undue influence fails.

CA statutory UI

In CA, any donative transfer will be deemed invalid if made to a drafter of a testamentary instrument, of someone related to or in business with such drafter, a fiduciary of the testator who transcribed the instrument, or a care custodian. If found, the portion will not be probated, to the extent that it is above what the person would have received in intestacy.

In this case, there are no signs that Sis had a hand in drafting or transcribing a will. Dora may argue that Sis was Wilma's care custodian, since she was elderly and alone. However, no signs indicate that she was in need of care. In fact, they attended social events together in public, implying that Wilma was quite capable of taking care of herself. Therefore, there is no statutory basis for undue influence.

Fraud in the inducement

A portion of a will affected by a person's affirmative misrepresentations to the testator, the falsity of which the person knew about, and intended to induce reliance upon, will be denied probate if it was justifiably and actually relied upon by a testator in making such portion of the will. It will rather pass to the residuary of the will, if there is one, or to a co-residuary, if already in the residuary, or to intestacy. Alternately, the court may impose a constructive trust to deliver the property to the intended beneficiary of the testator, had it not been for the fraud.

In this case, there are not enough facts to determine whether Dora or any other person misrepresented any facts to Wilma, such that she would have been induced to make a will entirely leaving her property to Sis. Dora will argue that the court should imply it, since Sis was the only person with access to Wilma and there would be no way to know whether there were such misrepresentations. If there has been, the will may be refused probate, but Dora likely cannot show this.

Pretermitted child

A child born or adopted after all testamentary instruments (wills, inter vivos, revocable trusts), and not provided for in them, will be deemed to have [been] inadvertently left out, and can take a statutory share in intestacy as if the testator had no such instruments. Here, both the trust and the will were made after Dora was born. Therefore, she cannot argue this.

Conclusion

Dora does not have very solid bases to argue that she should take Wilma's estate. If she can show that Sis exercised a disposition to coerce Wilma's will, her "ratification" in 2005 with the note would not save the will, and it would be denied probate, such that Dora could take. However, because it is difficult to

time when the relationship between Wilma and Sis blossomed, Dora's arguments are likely no good.

Sis's arguments

Validly executed will

A will is valid if witnessed by two witnesses and signed in their simultaneous presence by the testator. An interested witness who would take under the will would be presumed to have exercised wrongful influence. In this case, however, we are told that the will was validly executed, and there is no indication that Sis was a witness.

Therefore, because the will was validly executed, Sis should be able to argue that she can take the entire estate. She can raise defenses to each of Dora's claims, as explained above, and should succeed on all of them.

ESSAY QUESTIONS AND SELECTED ANSWERS
JULY 2008
CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the July 2008 California Bar Examination and two selected answers to each question.

The answers received good grades and were written by applicants who passed the examination. The answers were prepared by their authors, and were transcribed as submitted, except that minor corrections in spelling and punctuation were made for ease in reading. The answers are reproduced here with the consent of their authors.

Question 6

In 2000, Hal and Wilma, husband and wife, lived in New York, a non-community property state. While living there, Wilma inherited a condominium in New York City and also invested part of her wages in XYZ stock. Wilma held the condominium and the stock in her name alone.

In 2001, Hal and Wilma retired and moved to California.

In 2002, Wilma executed a valid will leaving the XYZ stock to her cousin, Carl, the condominium to her sister, Sis, and the residue of her estate to Museum.

In 2003, Wilma transferred the XYZ stock as a valid gift to herself and to her cousin, Carl, as joint tenants with the right of survivorship. Wilma sold the condominium and placed the proceeds in a bank account in her name alone.

In 2004, Wilma, entirely in her own handwriting, wrote, dated, and signed a document entitled, "Change to My will," which stated, "I give my XYZ stock to Museum." The document was not signed by any witness.

In 2007, Wilma died, survived by Hal, Carl, and Sis.

What rights, if any, do Hal, Carl, Sis, and Museum have to the XYZ stock and proceeds from the sale of the condominium? Discuss.

Answer according to California law.

Answer A to Question 6

This question concerns the rights of Wilma's survivors in the stock and proceeds from the sale of her condominium. Two areas of law will have effect on the ultimate deposition of the property, CA community property law and CA law governing will and de[s]cent. First, it is noted that Wilma may only devise her separate property and/or her share of the community estate. Therefore, it is necessary to look at the effect of community property laws to determine the ownership interest, if any, of Hal in the property which Wilma sought to devise, and then look at the impact of her testamentary actions to determine the ultimate ownership of the property.

The Basic Community Property Presumption

To begin, all property acquired during marriage while domiciled in CA is presumed to be community property (CP). Excluded from this presumption is all property acquired by gift, devise or descent. Finally, actions of the married couple may alter the character of the property during marriage and certain statutory presumptions may arise affecting the character. Finally, both husband and wife since 1975 are granted equal management and control over all community property, subject to certain limitations.

Quasi-Community Property

Quasi-community property (QCP) is all property acquired during marriage while domiciled outside of CA that would have been CP if acquired while domiciled in CA. In this case, because the couple lived in New York, a non-CP state, and the stock and condo were both acquired while there, they are QCP. QCP is treated as CP at death except that a decedent is not entitled to devise his QCP share of the surviving spouse's property. Because all the QCP devised here is the decedent Wilma's property, this does not apply and the QCP will be treated as CP.

The Condominium / Proceeds

Community Property Analysis

The condominium was acquired during marriage and would have been CP if acquired while domiciled in CA so it would be presumed QCP; however, the facts state that it was acquired by devise and is thus Wilma's SP. Therefore, the fact that it is titled in her name has no effect, and any proceeds, absent other facts, of the sale will also [be] her SP.

Therefore, as her SP she was free to devise it in its entirety, and Hal has no ownership interest in the condo or the proceeds therefrom.

Effect of the Devise

Valid Will

The question that next arises then is the validity of the gift to Sis. First, it is noted that the facts state that the 2002 will in which the gift was contained was valid. Therefore,

the initial gift of the condo to Sis is valid and she would take the condo. However, the facts also state that the condo was sold in 2003 and thus not a part of Wilma's estate when she died.

Ademption by Extinction
Therefore, the museum, as the residuary beneficiary, would want to argue that by selling the condo the gift to Sis was terminated, or adeemed. A gift is considered to be adeemed by extinction when the testator makes a specific devise of property, and then that property is either destroyed or sold prior to the testator's death. First, the museum will argue that the gift was specific, as it was for the Condo itself, and contained no language indicating that Sis be given a general "cash" gift out of the estate. Thus, because Wilma sold the condo, this specific gift was extinguished by sale, and the museum should therefore take the proceeds as the residuary beneficiary.

However, in CA, a gift will only adeem by extinction if it is shown that is what the testator so intended. In this case, the museum will point to the sale itself, the codicil naming the museum as the beneficiary of the stock as a demonstration of intent that the museum take all the property. Sis will argue that there is nothing to specifically indicate that Wilma intended to extinguish the gift. Further, because Wilma published her codicil in 2004, she could have also made a gift of the funds to the museum at that point but did not. Thus, this shows an intent to keep the gift to Sis in effect.

Without more information as to her intent, Sis will take the funds in the account.

The XYZ Stock

Effect of CP Rules

Source
Here, the XYZ stock was acquired with Wilma's earnings during marriage. Earnings during marriage, like property acquired during marriage, are CP. Even though these funds were acquired in New York, they would have been CP if acquired while domiciled in CA, and are therefore QCP, treated as CP upon death. Thus, because the stock was acquired with QCP, it will also be presumed to be QCP. Because it is presumed QCP, it is presumed Hal has ½ community interest in the stocks.

Effect of Title
In this case the facts state that Wilma held the stock in her name alone; thus the museum and Carl will want to argue that by placing the stock in her name alone, the community made a gift to her SP. However, since 1985 a transmutation of CP into SP requires a writing. In this case, there is no evidence that the community intended to make a gift to Wife of the funds to purchase the stock. Further, there is no writing that would support a transmutation of the funds into SP. Therefore, absent other evidence, the stocks remain CP, and as such, Hal owns a ½ community interest in the stock.

Gift of Community Property

Further, because spouses maintain equal control and management of community property, one spouse may not make a gift of community assets to another without the other spouse's consent. Here, Wilma has gifted the stock to herself and her cousin Carl in 2003. There is no evidence to indicate that this gift was approved of by Hal. When one spouse gifts community property to another without consent that spouse may void the gift during the donor's lifetime, or after the death of the donor void ½ of the gift. It is noted that the facts state the gift was "valid". It is not clear if this means valid under CP law, or a validly executed gift. Thus, if valid means that Hal consented to the gift, his ½ interest would be extinguished.

Therefore, because the stock was acquired with CP, Hal has a presumed ½ interest in it. Further, assuming valid does not mean he consented to the gift, because neither keeping title in her name alone nor giving the stock to herself and Carl is effective to eliminate this interest, Hal maintains a ½ interest in the stock.

The Devise of the Stock

Ignoring for now Hal's community interest, as stated above, Wilma validly gifted the stock [to] Carl in her 2003 will. The facts then state that the stock was gifted to both herself and Carl "as joint tenants with rights of survivorship". Therefore, prior to her death, the stocks were in joint tenancy with her, and Carl. The language used explicitly created the right to survivorship, and Carl, upon Wilma's death would automatically take all the stock.

The 2004 Codicil

The issue then arises as to the effect of the codicil made by Wilma in 2004. In CA a holographic codicil is valid as long as all material terms are in the handwriting of the testator, and the writing is signed by the testator. The other formalities of attested wills are not required. Therefore, as the document was entirely in her handwriting and was signed, it acts as a valid codicil to her 2002 will. Thus, the museum will argue that it takes the stock. However, because the stock was held as joint tenants with Carl, all of Wilma's interest in the stock will pass immediately to Carl. Furthermore, the attempted conveyance in the will is not effective to sever the joint tenancy, as it is not a present conveyance of her interest in the stock. Therefore, when she executed the codicil, she had no testamentary power over any interest she had in the stock. As such, the codicil would be ineffective to convey any interest in the stock upon her death to the museum.

Therefore, Carl retains his interest in the stock, and Museum will not take the stock under the codicil. Further, Carl's interest in the stock, because he received it by a gift of community property without Hal's consent, will be subject to Hal's ½ CP interest in the stock.

Therefore, Sis will likely take the funds in the account from the condo sale, Carl will take his interest as a joint tenant to the stock subject to Hal's ½ community interest, and the museum will take whatever is left over as the residuary beneficiary under the 2002 will.

Answer B to Question 6

The Rights of Hal, Carl, Sis, and Museum

The contribution of the assets and who is allowed to take is determined both by community property law and the law of wills. Because the important assets of the estate were acquired during marriage and Wilma died domiciled in California, all property that was acquired during marriage is presumptively community property, and if that property was acquired while married but outside of California then at the time of death it is treated as quasi-community property for purposes of distribution by the acquiring spouse, and is treated just like community property (i.e., the non-acquiring surviving spouse is entitled to a ½ interest in property). Furthermore, under California law, even when property is acquired during marriage, if it is acquired by gift, devise, or inheritance, it is treated as the spouse's separate property.

In order to determine the character of the item (as either CP, QCP, or SP), it is important to focus on the source of the funds, any actions taken by the parties to change the character of the property, and any presumptions that effect the property.

The Proceeds from the Condominium

The Character of the Proceeds

Wilma inherited the condominium in NYC while living in NYC. The condominium therefore is considered Wilma's SP even though it was acquired by Wilma during marriage. The proceeds from the condominium sale were then placed into a bank account in her name alone, and as such were not mingled with community property and completely retained their separate property character. Therefore, the proceeds, in the bank account in Wilma's name alone, are her SP and Hal has no ½ QCP interest in the property.

Furthermore, Hal cannot claim a pretermitted spouse status and then claim his intestate share of the SP because Hal and Wilma were married before all of Wilma's testamentary documents were executed.

Who Takes the Proceeds

Under the will executed in 2002, Wilma's sister, Sis, was specifically granted the condominium. However, because the condominium was sold the condominium is no longer in Wilma's estate and therefore there is the possibility of ademption by extinction.

Ademption by Extinction

Museum will argue that the gift to Sis was a specific gift and that because the gift was in fact sold that the gift is no longer in the estate that it has adeemed. Under the common law, the courts used an identity theory for redemption by extinction where, if a gift was a specific gift that could not be located in the estate of the decedent at the time of death, then the gift had adeemed and the specific devisee took nothing. If this were the case then the proceeds would pass to the residue of Wilma's will and therefore go [to]

museum. However, under California law, the court looks to the intent of the testator instead of using the identity theory both to determine if the gift was a specific [one] so as to determine if ademption by extinction even applies and then uses it to also determine if there was an intent to actually have the gift adeem.

Here, Sis may first argue that the gift was not specific but was instead general. While the actual phrasing of the will is not provided, the will likely used the words "my condominium" or "my NYC condominium" or something to that effect, which indicates a specific gift. Further, a gift of real property such as a condominium is virtually always a specific gift and therefore the court will reject her argument that the gift is general.

Second, Sis will argue that there was no intent to adeem. Under California law, besides generally looking at the intent of the testator, there is an automatic allowance to the specific devisee of anything [or] part of the property that remains and proceeds not yet paid for a condemnation sale, insurance proceeds, or installment contract, or where the gift is sold by a conservator (the specific devisee gets the FMV of the gift). However, it does not appear that any of these apply. On the other hand, Sis can argue that because the proceeds from the sale were placed into a separate account in Wilma's name alone and therefore the proceeds from the sale of the gift are easily traceable to one place and had not been used or commingled, that Wilma did not intend for the gift to adeem (essentially arguing tracing of the sale of the gift to the account), and therefore she should be entitled to the money from the sale of the condominium. It will be difficult for the court to accept this argument, but because it is a subjective determination, and Sis is Wilma's sister, the court may accept the argument and allow tracing. No other defense to ademption, such as change in form not substance, will work in this case.

Therefore, if the court accepts Sis's argument against ademption then she will be entitled to the proceeds of the condominium sale. However, if the court rejects the argument then she is not entitled to anything and as the residuary taker the museum takes the entire proceeds.

The XYZ Stock

Character of the Stocks

Wilma purchased the stocks by investing part of her wages into the XYZ stock. Presuming these wages were earned while married to Hal, the wages, and subsequently the stock purchased with them, would be considered community property had it been purchased while domiciled in California, and therefore it will be considered quasi-cp at the time of the acquiring spouse's death. However, Wilma took several actions that may have changed the character of the property.

First, Wilma placed the stock in her name alone. However, where the acquiring spouse uses community funds for the purchase of property and places the title in their name alone, the asset is presumptively untitled in that unless Wilma can prove that Hal intended a gift of his share of the property that the asset is actually community property

and each holds a ½ interest in the property (at least at Wilma's death). Because there are not facts indicating that Hal had intended to make a gift of his interest in the stock, he stocks, at this point, will still be considered QCP at death and treated like CP for distribution purposes.

Second, Wilma transferred by valid gift (presumably through a straw to create the four unities) to herself and to Carl the XYZ stock as joint tenants with the right of survivorship. If this transfer had been valid, this would have destroyed the QCP aspect of the property. However, this was not a valid gift of Hal's interest in the property. Under California Law, a surviving spouse may set aside to the extent of one half any transfer or gift of quasi-community property at death when the decedent spouse died domiciled in California, that the decedent spouse did not receive substantial consideration for the gift, and the decedent spouse had retained an ownership or use interest in the property. Here, Wilma may have made the transfer, and at her death the joint tenancy may have passed her interest automatically over to Carl, but Hal will be able to set aside to the extent of ½ of the interest because it was a gift and she had retained an ownership interest in the property at the time of her death.

<u>The Effect of the Will</u>
Under the original will, Carl was able to be the taker of the XYZ stock. However, in 2004, Wilma executed a holographic codicil to the will that stated that Museum was not to take the XYZ stock instead. However, Museum will not take any interest in the XYZ stock.

First, Carl may argue that the codicil was invalid because it was not formally attested. However, under California law, so long as the material provisions of the will are in the testator's handwriting and the testator signs the will, this will be an effective holographic will, or in this case, a holographic codicil. Here, Wilma signed, dated, and in her own handwriting wrote that it was a change to the prior will and that Museum was not to take the XYZ stock. Therefore, the material provisions (who takes and what they take) are in Wilma's handwriting and she signed the codicil, which is al that is required under California law. As such, this was a valid codicil and did change her 2002 executed will (which was presumably attested).

Second, Carl will argue that the will was ineffective to evoke the joint tenancy and therefore he was entitled to the full XYZ stock (minus Hal's forced interest). The Museum will argue that the codicil did effectively sever the joint tenancy because it was drafted after the joint tenancy was entered and conveyed away Wilma's interest. However, in all likelihood, the court will reject this argument because while a will is interpreted (or a codicil for that matter) at the time of its execution, it is not actually given effect until when the will is probated (i.e., after the testator's death). Therefore, the actual gift, and therefore, the severance by conveyance, would not have occurred until after the death of Wilma. Unfortunately for Museum, there was nothing to convey at this point because the entire interest in the property had passed, as a matter of law, to Carl as having right to survivorship rights. Therefore, while Hal can set aside ½ of the

transfer for his forced share, Museum has no similar rights and will not take the stock because there was nothing left of it to devise.

Conclusion:

In the end, the court will likely grant the entire condominium proceeds to Sis, and then Hal will be allowed to force a ½ share in the XYZ stock under the California Probate Code, Carl will get the entire XYZ stock (subject to the forced share by Hal) by operation of law, and the Museum will take neither of the assets.

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ESSAY QUESTIONS AND SELECTED ANSWERS
FEBRUARY 2011
CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the February 2011 California Bar Examination and two selected answers to each question.

The answers received good grades and were written by applicants who passed the examination. The answers were prepared by their authors, and were transcribed as submitted, except that minor corrections in spelling and punctuation were made for ease in reading. The answers are reproduced here with the consent of their authors.

Question 1

In 2004, Tess, a widow, executed a valid will leaving her estate to her children, Abel, Bernice, and Cassie *per stirpes*.

In 2009, Tess, Abel, and Bernice quarreled and Tess decided to draft a new will. She went to an office supply store, got a preprinted will form, and filled in the following in her own handwriting:

> Because my son Abel and daughter Bernice have been unkind to me, I specifically disinherit them. I give and bequeath all my property to University.

Tess signed and dated the form. No one was present when she signed and dated the form and hence no one signed as a witness to her signature. At the time, she was addicted to prescription pain killers and was an alcoholic.

In 2010, Cassie adopted David as her son. Soon thereafter, Cassie died, survived by David.

In 2011, Tess died, leaving an estate worth $1,000,000.

Tess's 2009 will has been offered for probate.

(1) What arguments can Abel and Bernice reasonably make in objecting to the validity of Tess's 2009 will? Discuss.

(2) Does David have any claim to a share of Tess's estate? Discuss.

Answer according to California law.

Answer A to Question 1

(1) What arguments can Abel and Bernice reasonably make in objecting to the validity of Tess's 2009 will?

A. Was the first will revoked?

Abel and Bernice can first object that Tess's 2004 will wasn't revoked by the subsequent will drafted in 2009. A will can be revoked either expressly or impliedly. Express revocation requires the testator to use language that makes his intent clear that the original will is revoked by a later will. A will can be impliedly revoked if the second will contradicts with the first will and the second will bequeaths substantially all of testator's property. Here, unlike in the first will where Tess left Abel and Bernice part of her estate, Tess specifically disinherited Abel and Bernice. A testator can disinherit those who would take if testator died intestate (here, her children) by expressly using language that she intends to disinherit them in her will. Because the second will contradicts the first will and bequeaths all Tess's property to a different person (University), the will was validly revoked by implication and the second will can be probated if it is proved valid. It is clear Tess intended the second will executed in 2009 to revoke the 2004 will and not be a codicil because she specifically contradicts a provision stated in her first will (to Abel, Bernice, and Cassie per stirpes) and then Tess in her later will left all of her property instead to University.

B. Objection that 2009 will is not a valid will

(1) <u>Was this a valid attested will</u>?

California does not allow oral wills. Therefore, a valid attested will must be (1) Written, (2) Signed by Testator, (3) in the presence of 2 witnesses who have to sign before testator's death, but not necessarily in his presence. Also, [if] testator doesn't

sign in the two witnesses' presence, it can be valid if he later acknowledges the signature on the will as his with witnesses present, who sign then or before T's death. Even if there are no witnesses, as long as (1) and (2) (writing and signed by T) are satisfied, extrinsic evidence or testimony can be offered that proves that T either in writing or orally expressed his intent that this writing be his will. This has to be proved through clear and convincing evidence. Here, Tess's will is likely not a valid attested will. Even though the will was in writing and signed by Tess, there were no witnesses to her signature. For this will to be considered valid, there would need to be clear and convincing evidence that Tess intended this to be her will or that later Tess acknowledged the signature as hers and witnesses sign. Since those facts are not included here, Tess's will is not a valid attested will.

(2) Valid holographic will?

Tess's will will likely be considered a valid holographic will. A holographic will doesn't have to be fully in the testator's handwriting, but all material provisions must be solely in the T's handwriting. Material provisions include the beneficiaries who will take must be named and specify the gifts they will receive. A holographic will must also be signed by T to be valid. Here, Tess's 2009 will includes all material provisions. Tess specifically names University as the beneficiary and specifically names the gift they will take - "all my property". Tess signed the will, satisfying the signature requirement. The holographic will is also dated, which is not required but helps a court when a will is offered for probate to know the order in which wills were executed. Even though the will was printed on a preprinted will form, this is not of consequence. Therefore, since Tess named a specified beneficiary (University) and specifically named what property they would take (all) in her own handwriting, and signed the will, all material provisions required of a holographic will exist and Tess's 2009 will would be considered a valid holographic will in California. For the reasons listed above, Tess's 2004 will was revoked, and her 2009 will should be probated, if it is found that Tess had the capacity at the time of execution of the 2009 will (discussed below).

C. Did Tess lack capacity when the 2009 will was executed?

A testator who executes a will must have capacity when the will is executed for the will to be considered valid and to be offered for probate. Capacity requires several things: (1) T must be at least 18, (2) T must understand the natural objects of her bounty, (3) must understand the nature and value of property, and (4) T must understand she is making a will. Here, Tess's capacity could be questioned because she was both addicted to prescription painkillers and was an alcoholic at the time she executed the will. A person could be considered to lack capacity normally but have times of being lucid. If the will is executed during a lucid period, then T will be considered to have met the capacity requirement. (1) The first element required for capacity here can likely be assumed. It seems Tess is over the age of 18 since she was already widowed and had three children, and presumably died of natural causes not many years after her 2004 will. (2) It appears that T understood the natural objects of her bounty (her children). This is possible because she specifically refers to her children who she knew would take either under her 2004 will or by intestate succession - Abel and Bernice. She made a point to disinherit them, and at least knew some of the natural objects of her bounty. Though, because Tess didn't list Cassie (who would also be a natural object of her bounty), it is possible she didn't understand all the natural objects of her bounty. (3) It is not clear that Tess understood the nature and value of her property. She only stated "all my property". She didn't specifically list any property but only made a blanket statement referring to the whole of her property. It is not clear that she understood the disposition of her property. (4) It is clear that Tess understood she was making a will. Her language specifically "disinherited" two of her children and then she "bequeathed" her property to University. Tess also wrote these statements on a preprinted will form that she went to an office supply store to buy. It appears that because Tess used certain language and wrote her bequests on a will form, she understood that she was making a will. Because Tess didn't even refer to Cassie (which questions whether she understood the natural objects of her bounty) and because Tess only bequeathed "all" her property instead of listing out certain

dispositions, it is possible that Abel and Bernice could prove that Tess lacked the capacity to make the 2009 will.

(2) Does David have any claim to a share of Tess's estate?

A. Capacity

It is possible that David has a claim to Tess's estate. Adopted children inherit from their parents just as if they were natural born children, so David will be able to take any gift that his mother Cassie would've been able to take had she been living. If it is found that Tess lacked the capacity to execute the 2009 will (for the reasons listed above), and the 2004 will was never validly executed, then David could take his mother's share that was devised under the 2004 will. Since Tess wanted her estate distributed to Abel, Bernice and Cassie per stirpes, that means that the estate is divided equally at the first level where there is issue left (whether anyone is living on that level or not). Here, if Tess's estate was divided per stirpes, Abel, Bernice and Cassie's issue - David - would all inherit equal shares - 1/3 of the estate.

B. Pretermitted child

If the 2009 will is found to be valid, then David could argue that Cassie was a pretermitted child, but this argument is likely to fail. A pretermitted child will be provided for if they were born/adopted after a will was executed, were not provided for in the will, and (1) were not provided for outside of the will, (2) all the estate wasn't left to their other parent, or (3) they weren't expressly disinherited. Here, because Cassie was already living when Tess's will was executed, she cannot claim as a pretermitted child, even though she wasn't expressly disinherited. David would not be able to argue under the pretermitted child statute, even though he was adopted after the will, because he is the grandchild and not child of T. Therefore, Cassie nor David would be considered a pretermitted child and David does not have a claim under as a pretermitted child.

Answer B to Question 1

1. Arguments Abel and Bernice can make objecting to the validity of Tess's 2009 Will:

Revocation of the 2004 Will

In 2004, Tess executed a valid will leaving her estate to Abel, Bernice, and Cassie. The issue is whether Tess's 2009 will revoked the 2004 will. A will may be revoked by a subsequent will (1) if the subsequent will is validly executed; and (2) if the testator simultaneously had the intent to revoke the prior will. Revocation may be express (e.g., "I revoke all prior wills and codicils"), or implied (a) to the extent that the wills are inconsistent; or (b) if the subsequent will makes a complete disposition of the testator's entire estate, then the prior will is revoked in its entirety.

Here, [Tess] did not expressly revoke the 2004 will in her 2009 will, because the 2009 will did not mention the prior will. However, Tess stated in her 2009 will that she "specifically disinherit[s]" her son Abel and Bernice. This statement is inconsistent with the 2004 will's disposition of Tess's entire estate to her children Abel, Bernice, and Cassie, so the 2004 will would be implicitly revoked as to its devises to Abel and Bernice, provided that it is validly executed or a valid holographic will. Moreover, Tess's 2009 will stated that she bequeaths "all my property to University," which is a complete disposition of her estate. As such, a court would likely find the 2004 will to be revoked in its entirety, if the 2009 will is valid.

The issue, therefore, is whether the 2009 will is a validly executed attested will, or a valid holographic will.

Validly Attested Will

Abel and Bernice will argue that the 2009 will failed to comply with the required formalities for a validly executed attested will. To be valid, an attested will must be: 1) in writing; 2) signed by the testator, or by another person in the testator's presence and at her direction; 3) the testator's signing or acknowledgement of the will must occur in the

joint presence of at least two witnesses; 4) the two witnesses must sign the will within the testator's lifetime (though not necessarily in the testator's presence, or in the presence of each other); and 5) the two witnesses must have understood at the time that they were witnessing the testator sign her will.

Here, Tess's 2009 will was in writing (on the preprinted will form), and she signed and dated the document. However, there were no witnesses to Tess's signing of the will, and no witnesses signed the document. Thus, Tess's 2009 will failed to comply with the formalities required of a validly attested will.

Clear and Convincing Evidence Exception After 2009

After Jan. 1, 2009, a will which complies with the signature and writing requirements, but fails to comply with the witnessing requirements, may nonetheless be admitted to probate if the proponent of the will is able to produce clear and convincing evidence that the testator intended the document to be her will. Here, University (the party who stands to benefit from the 2009 will being valid) will argue that, since Tess's 2009 will was executed after this new rule went into effect, and since she signed and wrote portions of the will in her own handwriting, there is sufficient evidence to admit the will into probate.

This argument will probably fail. Abel and Bernice will argue that, as discussed infra, the fact that Tess was on painkillers and was an alcoholic at the time she signed the 2009 will weighs strongly against finding that there was clear and convincing evidence of her intent. Moreover, Abel and Bernice will argue that the clear and convincing evidence exception is usually only successfully employed when a testator attempts to comply with the witnessing requirements, but fails due to a technicality such as the two witnesses not being jointly present at the same time, or failing to sign the document within the testator's lifetime. Here, Tess had no witnesses present whatsoever. Moreover, Tess created the will on a preprinted will form, rather than going through the more formal procedure of having an attorney draft up a customized will. They will also point out that the will illogically does not mention Cassie. All of these

circumstances will likely persuade the court not to apply the clear and convincing evidence exception in this case. As such, the 2009 will will not be admitted to probate as a validly attested will.

Holographic Will

University will argue that, even if the 2009 will is not validly attested, it qualifies as a valid holographic will. A holographic will is valid if (1) the material terms (including all beneficiaries and bequests) are in the testator's own handwriting; and (2) the testator signs the will. A holographic will can indeed revoke a prior attested will (that was typed).

Here, all material terms in the 2009 will were in Tess's own handwriting. This included specifically disinheriting Abel and Bernice, and bequeathing "all my property to University." Tess additionally signed and dated the will. (A holographic will need not be dated, but an undated holographic will would be invalid to the extent that it conflicted with other wills. Since this will was dated, that is not a problem.)

Abel and Bernice will argue that not all material terms were included in Tess's handwriting because she failed to mention Cassie in the 2009 will. This argument will likely fail. Tess's statement in her own handwriting that "I give and bequeath all my property to University" is a complete disposition of her estate. Specifically mentioning Cassie was not necessary. As such, a court would likely admit the 2009 will to probate as a valid holographic will, provided that they find there was sufficient evidence of testamentary intent.

Capacity

Abel and Bernice will argue that Tess lacked capacity at the time she executed the 2009 will. To have capacity to execute a will, a testator must: 1) be over 18 years old; 2) know the extent of her property; 3) know the natural objects of her bounty (e.g., heirs); and 4) understand the nature of the act of executing a will.

Tess was presumably at least 18 years old in 2009, seeing as she was a widow and had three children. Abel and Bernice will argue that Tess lacked capacity because she was addicted to prescription painkillers and was an alcoholic. However, this evidence will likely be insufficient under these facts. All testators are presumed to have capacity, and the burden will be on Abel and Bernice to present evidence that Tess lacked capacity at the precise time she executed the 2009 will. Merely showing that she was addicted to painkillers and was an alcoholic will not be enough. They would need to prove that she was high or drunk at the time she executed the document. Given that she had the capacity to go to an office supply store, purchase a preprinted will form, and write legibly in her own handwriting, it is likely that she knew the nature and extent of her property. She also specifically referenced the natural objects of her bounty (Abel and Bernice), although they will point to the fact that she left Cassie out of the will as evidence that Tess was not completely aware at the time. However, Tess did mention that Abel and Bernice "have been unkind to me," which logically might be a reference to the fact that they quarreled recently. Ultimately, the fact that Tess left out Cassie will likely not be sufficient to prove that she lacked capacity at the time she executed the will. She clearly understood the nature of the act of executing a will; otherwise she would not have been able to purchase the will form and execute it without help.
Accordingly, Abel and Bernice's capacity defense will fail.

Insane Delusion

Even if a testator had capacity at the time she executed a will, affected parts of a will will be invalid if (1) the testator had a false belief; (2) which was the product of a sick mind; (3) there was no evidence supporting the belief; and (4) it affected the will.

Here, there is no evidence that Tess had any false beliefs about her quarrel with Abel and Bernice. Accordingly, this defense will fail.

Conclusion

Because Tess's 2009 will is a validly executed holographic will, and because Abel and Bernice's capacity and insane delusion defenses will fail, Abel and Bernice likely will fail in objecting to the validity of the 2009 will.

Final Note re Dependent Relative Revocation

Under the doctrine of dependent relative revocation, a will which the testator revokes in anticipation that a subsequent will would be valid may nonetheless be admitted to probate if the prior will turns out to be invalid. However, this doctrine would not apply here in any instance, because the 2004 will was not revoked by physical act. If the 2009 will was invalid, then the 2004 will would have never been revoked. As such, the doctrine of dependent relative revocation would not need to be invoked to save the 2004 will, because the 2004 will would have never been revoked by the 2009 will in the first place.

2. David's Claim:

Adopted Children / Intestacy

David is an adopted child of Cassie, who is Tess's son. When a child is adopted, it severs any right to inherit from their blood parents, and the adopted child is treated the same as a blood child of the adopting parent for purposes of wills and intestacy. Here, Cassie died in 2010, survived by David. If Cassie died intestate (i.e., without a will), and if David is her only son, David would inherit Cassie's entire estate. The question, therefore, is whether Cassie would have inherited any of the $1,000,000 in Tess's estate.

Per Stirpes

If Cassie were to inherit under the 2004 will, she would receive a "per stirpes" split of the $1,000,000, which would be one third (an equal division between all three of Cassie's children), for about $333,333. [David] would inherit this amount as the only

heir of Cassie. However, we must first determine if Cassie would take anything after the 2009 will.

Pretermitted Heir

David might try to claim that Cassie was a pretermitted heir. A child which is born after the testator executed all testamentary instruments (wills, codicils, and trusts), but is not provided for in any of them, may nonetheless receive her intestate share. This doctrine will not apply here because Cassie was already alive when both the 2004 and 2009 wills were executed by Tess.

Revocation of 2004 Will

Because Cassie is not a pretermitted heir, whether David can take will depend on whether the 2009 will is valid, and whether the 2004 will was revoked by the 2009 will. As discussed above, the 2009 will is likely a valid holographic will, and because the 2009 will made a complete disposition of Tess's estate ("all my property to University"), a court is likely to find that the 2004 will was implicitly revoked in its entirety. If the court adopts this view, Cassie would not inherit under the 2009 or 2004 wills, and David accordingly would be entitled to no share of Tess's estate.

Assuming the 2009 Will is Invalid

Assuming, arguendo, that the 2009 will is invalid, then David would argue that he is entitled to a 1/3 share of Tess's estate because (a) Cassie would have inherited 1/3 under the 2004 will, and (b) David is Cassie's only heir. The issue, under these circumstances, would be whether the fact that Cassie predeceased Tess caused her bequest to Cassie under the 2004 will to lapse.

Lapse

Under the common law rule of lapse, if a beneficiary of a testator's will predeceased the testator, any bequests to the beneficiary would lapse (i.e., fail), and would fall into the residuary of the will (the block of remaining property after all specific,

general, and demonstrative devises). Here, because Cassie predeceased Tess, her bequest would lapse under the common law rule, and David would take nothing.

Antilapse Statute

However, California, like most states, has adopted an antilapse statute. Under the statute, a bequest will not lapse if (1) if is to the testator's kindred, or kindred of a former spouse; and (2) the beneficiary leaves issue. Here, Cassie is Tess's kindred because she was Tess's daughter. Moreover, Cassie left David as issue. Accordingly, her bequest would not lapse under the antilapse statute, and Cassie's bequest of 1/3 of Tess's estate (under the 2004 will) would pass to her issue, David.

Conclusion

The 2009 will is likely a valid holographic will which revoked the 2004 will in its entirety. As such, Cassie's estate would be entitled to nothing under the 2009 will, and David would take nothing. However, if the court finds that the 2009 will was invalid, then Cassie's estate would take 1/3 of the $1,000,000 in Tess's estate under the 2004 will, which would pass to David via intestacy.

ESSAY QUESTIONS AND SELECTED ANSWERS
JULY 2012
CALIFORNIA BAR EXAMINATION

This publication contains the six essay questions from the July 2012 California Bar Examination and two answers to each question that were written by actual applicants who passed the examination after one read.

The selected answers were assigned good grades and were transcribed for publication as submitted, except that minor corrections in spelling and punctuation were made for ease in reading. The answers are reproduced here with the consent of their authors.

Question 5

In 2004, Mae, a widow, executed a valid will, intentionally leaving out her daughter, Dot, and giving 50 per cent of her estate to her son, Sam, and 50 per cent to Church.

In 2008, after a serious disagreement with Sam, Mae announced that she was revoking her will, and then tore it in half in the presence of both Sam and Dot.

In 2010, after repeated requests by Sam, Mae handwrote and signed a document declaring that she was thereby reviving her will. She attached all of the torn pages of the will to the document. At the time she signed the document, she was entirely dependent on Sam for food and shelter and companionship, and had not been allowed by Sam to see or speak to anyone for months. By this time, Church had gone out of existence.

In 2011, Mae died. Her sole survivors are Dot and Sam.

What rights, if any, do Dot and Sam have in Mae's estate? Discuss.

Answer according to California law

ANSWER A TO QUESTION 5

Sam's Rights

In 2004, Mae executed a valid will that left 50% of her estate to her son, Sam, and 50% of her estate to Church.

Revocation of 2004 Will

A will can be revoked by physical act. This requires that the testator tear, cancel, obliterate, or destroy the will with the contemporaneous intent to revoke it. Here, in 2008, Mae had a disagreement with Sam and announced that she was revoking her will as she tore the will in half, in the presence of both Sam and Dot. Because she announced that she was revoking the will, that shows that she had an intent to revoke it. Additionally, she got into a fight with Sam prior to this, and Sam was to take 50% of her estate under that will. That further evidences that she intended to revoke the will. She tore the will in half, which is a sufficient physical act. Thus, her actions in 2008 are sufficient to count as a revocation by physical act. At this point in 2008, because Mae revoked her only will, she does not have a testamentary instrument.

Revival in 2010

Holograph

A holographic will is one that is signed by the testator and all of the material terms are in the testator's handwriting. Material terms are the beneficiaries and the gifts. In 2010, Mae handwrote and signed a document that stated she was reviving her will. Although it is signed by Mae and in her handwriting, the material terms are not in her handwriting because they are referenced. Thus, this will only be a valid holograph if the 2004 will can be incorporated into the 2010 handwritten note because the 2004 will contains the material terms.

Incorporation of the 2004 Will

A document will be incorporated as part of the will if it was physically present at the time the will was executed and there was a simultaneous intent that the document be a part of the will. Here, it seems that the torn pieces of the 2004 will were physically present when Mae wrote the holograph because there are no facts suggesting she had to go anywhere to get it; rather the facts seem to suggest that she wrote the holograph and attached the torn pages in one sitting. Thus, it can be presumed that the prior will was physically present when she wrote the holograph.

Furthermore, Mae had intent to incorporate the prior will because she physically attached the torn pages of the will to the holograph document. This is sufficient to prove her intent to incorporate.

Because the prior will was physically present and was intended to be a part of the holograph, it will be revived in accordance with Mae's intent.

Incorporation by Reference

A writing can be incorporated by reference into a will if (1) there is a writing, (2) it existed at the time of the will's execution, (3) it is specifically referenced in the will, and (4) the testator had the intent to incorporate the writing.

Here, the 2004 will was in writing because it was valid at the time it was executed, so it must have been in writing to be valid. It existed at the time of the will's execution because Mae still had the torn pages. It is irrelevant that at that time it was not a valid testamentary document, so long as it physically existed. It was specifically referenced within the 2010 will because she stated that she wanted to revive her will, and she only had one prior will that had been revoked. Furthermore, she attached the torn pages to the 2010 will, so it is evident that she is talking about the 2004 will. Because the first three elements are satisfied, there is a presumption that Mae had the intent to incorporate the 2004 will into the 2010 holograph.

Independently Significant Fact

A fact is independently significant if it would have existed regardless of the testamentary document being executed. Here, the 2004 will would have existed regardless of the 2010 holograph because it was written prior to the 2010 holograph. Even if Mae had never written the 2010 will, the 2004 will would have existed, regardless of the fact that she revoked it. The torn pieces still remained. Thus, the 2004 will is independently significant.

Validity of 2010 Will: Undue Influence

Dot, who takes nothing under the revived will, will argue that the 2010 will was the product of undue influence, and is therefore invalid, leaving Mae without a testamentary instrument. There are three types of undue influence recognized in California: the prima facie case, case law undue influence, or statutory undue influence.

Prima Facie Case

Under the prima facie case, undue influence can be shown if the testator was susceptible to undue influence, if there was an opportunity to influence her, if there was action taken to cause undue influence, and there was an unnatural disposition of the estate because of the undue influence.

Here, Dot will argue that Mae was susceptible to undue influence by Sam because she was entirely dependent on Sam for food, shelter, and companionship. Thus, she was susceptible to doing what Sam wanted her to do. Dot will argue that Sam had the opportunity to influence Mae because she was so dependent on him, Mae felt that if she did not do what he wanted, she would have been left without food, shelter, or companionship. There was active participation by Sam because he had repeatedly requested that Mae revive the 2004 [will] and would not allow Mae to see or speak to anyone for months. Finally, Dot will argue that the gift in the 2004 will was unnatural because it did not provide for her, Dot, Mae's own daughter. Sam will argue, on the

other hand, that the gift revived by the 2010 will was not unnatural because it was a will that was validly executed in 2004. There was nothing unnatural about it in 2004, and there is nothing unnatural about it now. Furthermore, Mae intentionally left Dot out of the will in 2004, so it was not unnatural to be left out now. Finally, Sam will argue that Mae was not susceptible to any undue influence by him; rather he was just taking care of his aging mother.

Ultimately, the court will probably side with Sam, that there was not an unnatural disposition of Mae's property in the 2010 instrument because it was merely the revival of a valid gift that she had already devised, despite the fact that she later revoked it. Thus, the will will not be found invalid because of prima facie undue influence.

Case Law Undue Influence

Under case law undue influence, a gift or a will is invalid if there was a confidential relationship between the testator and the person accused of having undue influence, if there was active participation by the person causing the undue influence, and if there was an unnatural gift because of the undue influence. Here, there is a confidential relationship between Sam and Mae because Sam is Mae's son and he is solely responsible for taking care of her. Mae is entirely dependent on Sam, so there is a confidential relationship.

See above for arguments regarding active participation by Sam and the fact that the gift was not an unnatural disposition of property.

Because the revival of the 2004 will by the 2010 will was not an unnatural disposition of property, discussed above, there will be no undue influence.

Statutory Undue Influence

Under the California Probate Code, undue influence is presumed if the drafter of the will is also the beneficiary of the will. Here, Mae handwrote the 2010 holograph and attached the torn pages to that will herself. Thus, no one else drafted the will. The fact that she did so at the repeated requests of Sam does not change the fact that he did not draft the will leaving a gift to himself. Even if he did, there is an exception to this general rule that if the drafter is also a relative of the testator, there is not going to be a presumption of undue influence. Thus, there is no statutory undue influence.

Disposition re: Sam

If the court finds that there is no undue influence, the court will dispose of Mae's estate in accordance with the 2010 will, which incorporates the 2004 will. Under that document, Sam is entitled to 50% of Mae's estate, and Church is entitled to the other 50%.

Church: Lapse of Gift

Church was no longer in existence in 2010, when Mae executed her will. Thus, her gift of 50% of the estate will lapse because Church does not exist and is not there to take its gift.

Anti-Lapse?

California has an anti-lapse statute, which allows for the issue of a kindred beneficiary to take, despite the fact that he or she may have predeceased the testator. Here, however, Church is not kindred, or blood-related, to Mae, nor does it leave issue because it is an entity. Thus, anti-lapse will not apply to Church's gift of 50%.

Remaining 50%: Intestacy

Because the gift of 50% of Mae's estate to Church will lapse, the will does not provide for the distribution of that property. Thus, the remaining 50% of Mae's estate will pass through intestacy.

Mae was a widow when she died, so she did not leave a surviving spouse. She was survived solely by Dot and Sam, her children. Under the rules of intestacy, if a decedent dies without a will or without full disposition of property by a will, the property will go to the surviving issue, per capita. Under California Probate Code section 240, you go to the first generation with living issue and divide the estate equally among bloodlines with someone living. Here, Sam and Dot are both living, and they are in the first generation. Thus, they will each take 50% of the remaining estate - in other words, they will get 25% of Mae's estate each.

Dot's Rights

Dot was intentionally left out of the 2004 will, which later was revoked and then incorporated into the 2010 will. Thus, under Mae's will, Dot stands to take nothing (with the exception of her 25% intestate share due to the lapse of Church's gift).

Pretermitted Child

Dot will argue that she is a pretermitted child. A pretermitted child is one that was not born or known about at the time the testamentary instrument was executed. Pretermitted children are entitled to their intestate share of the entire estate. Thus, if Dot is pretermitted, she will be entitled to 50% of Mae's estate because Mae's estate would be split 50/50 between her two children in intestacy.

Here, Dot is not a pretermitted child because she was alive in 2004 when Mae executed the will. Furthermore, Mae intentionally left her out of the 2004 will and she revived that will, with the intent that it go back into effect. Therefore, Dot will not be construed as a pretermitted child.

Distribution of Mae's Estate

If Dot is able to persuade the court that there was undue influence by Sam, his gift will be invalidated because of the undue influence. If Sam's gift is invalid and Church's gift lapse, that would mean Mae's entire estate would be distributed through

intestacy. In this case, Dot and Sam, as the sole surviving children, would be entitled to 50% each.

However, as discussed above, the court is unlikely to find that undue influence will invalidate Sam's gift because it was not unnatural. Therefore, Sam will still be entitled to his 50% under the will. Because Church's gift lapsed, however, the remaining 50% will be distributed under intestacy, with 25% going to each Sam and Dot. Thus, the most likely distribution of Mae's estate results with Sam taking 75% of the estate, and Dot taking 25%.

ANSWER B TO QUESTION 5

2004 - Valid Will

The facts here indicate that Mae executed a valid will in 2004 in which she intentionally omitted D, and split her estate 50/50 between S and the Church.

2008 - Revocation

A will can be revoked by physical act or subsequent testamentary documents. When revoking by physical act, testator, or someone under testator's direction must burn, tear, destroy, or cancel the will. The testator must have the intent to revoke at the same time. Here, in 2008, after a disagreement with S, M announced that she was revoking her will, thereby indicating an intent to revoke, and then she tore it in half, fulfilling the necessary physical act to revoke. Because she tore the entire will in half, there is an indication that she intended to revoke the entire will, not just a part of it.

As such, Mae effectively revoked her 2008 will.

2010 - Revival

A will can only be revived if it was revoked by a subsequent testamentary instrument, which was then later revoked by physical act or another testamentary instrument. Revival re-effectuates an earlier will. Here, Mae's 2004 will was revoked by physical act, not by testamentary instrument, so it cannot be revived by a document. Had this will been revoked by a later instrument, S could argue that the first will was revived because his mother executed a holographic codicil that explicitly stated that she intended the earlier will be back in effect, and it would have been effective as of the date of the codicil.

However, a will revoked by physical act cannot be revived.

2010 - Holographic Will

S could argue that in 2010, his mother executed a holographic will. A valid holographic will requires that all material terms of the will be in the testator's handwriting, and it be signed by her. Here, Mae wrote that she was reviving her will and she signed the

document. He could argue that even though this was not a valid revival, as discussed above, it was a new will because testamentary intent can be inferred from her statement that she wished to revive the earlier will, and she had signed and handwritten this new will. Therefore, Sam may be able to argue that this was a new, valid holographic will.

To establish the terms of the will, he could look to integration, and incorporation.

Integration

A writing that is present at the time of the execution of a will, and is intended to be a part of that will, is deemed to have been integrated into the will and is probated. An intent to make it a part of the will can be established by it being attached to the will. Here, S could argue that even though the previous will had been revoked, the pieces of it were attached to the holographic will that his mother executed, and therefore, it was integrated into the new will and should be probated. There is no requirement that the attached documents be valid on their own. Therefore, Sam may be successful in arguing that his mother's former will was integrated into the holographic will.

Incorporation by reference

A writing, whether valid or not, can also be incorporated by reference if it is in existence at the time of the execution of the will, it is identified in the will, and there is an intent to incorporate it. Sam could again argue that if his mother's will was not integrated, it was incorporated by reference because she states in the new will that she is reviving her former will, which indicates that she intended to incorporate it, and it is clearly referenced in the new will. He can also argue that even though it was in two pieces, it was still in existence at the time of the execution of this will. Thus, it was incorporated by reference.

Undue Influence

Courts are unwilling to probate wills or terms of a will that are procured by undue influence. Undue influence is when the testator's freewill is overcome. There are two types of undue influence that the court may find were at play when Mae wrote the

document attempting to revive her former will: prima facie undue influence and undue influence based on case law.

Prima facie

To establish a prima facie case of undue influence, a party contesting the will, which in this case could be D because she receives nothing under her mother's initial will, would have to show her mother's susceptibility to be influenced, her brother's opportunity to influence Mae, S's active participation in influence, and an unnatural result.

Susceptibility

Mae must have been in a vulnerable position in which her freewill could have been overcome. In this case, she was completely dependent on S for her basic necessities in life, such as food, shelter and companionship. Therefore, she was very likely susceptible to having her freewill overcome by Sam.

Opportunity

S must also have had the opportunity to overcome Mae's freewill. In this case, Sam did not allow Mae to see or speak to anyone for months, and his mother completely relied upon him. Therefore, because he was her only source of companionship, he had the opportunity to influence her.

Active participation

S must have actively influenced his mother. Here, he made repeated requests to her to revive her former will, and it was only after these repeated requests that she did so. Therefore, he actively participated.

An unnatural disposition

Proving an unnatural disposition may be difficult for D because the original will devised half of Mae's property to S and that's also what the new will would do. Furthermore, if Mae died intestate, he would still receive half of her property because

she only left behind two issues. However, because it is clear that Mae intended to tear up her old will, and that this second document was only the result of S's pressure on her, it may be possible for find undue influence.

Case law

Under the case law method of proving undue influence, there has to be a special relationship between the influencer and the testator, active participation and an unnatural result. Here, the special relationship can be established through the familial bond, as S was Mae's son, and she was completely dependent on him to take care of her. See above for the other two elements.

As a result, if the court were to find that there was undue influence, it would likely refuse to probate the second will because the entire thing was obtained by such an influence. On the other hand, because the disposition wasn't entirely unnatural, it may not find undue influence, in which case it would be a valid will that could be probated.

Gift to the Church

In order to obtain a gift under the will, one must be in existence at the time of testator's death. The church here was no longer in existence when Mae died. Under California's lapse provisions, the gift to the church would lapse and fall into the either the residuary clause of the testator's will, and if there wasn't one, then it would pass under intestacy. The gift cannot be saved under the antilapse provisions because only kindred who leave behind issue can benefit from that provision.

As such, if there was a valid will, the gift to the church would lapse, and as there is no residuary clause, it would pass under intestacy.

Dot's Rights

Omitted Child

Dot could claim that she was an omitted child because she was not provided for in any of Mae's wills. However, to be an omitted child, all testamentary documents must have

been executed prior to the birth of the child. Here, the facts clearly indicate that D was alive when Mae executed her will in 2004, and then also again in 2010 if that is deemed to be a valid will, and thus she was not an omitted child. Furthermore, Mae intentionally left D out.

Intestacy Share

D's intestacy share will depend on whether the holographic will by Mae is considered valid or invalid.

If the will is valid, 50% of her estate would pass under the will to S. The other 50% that was to go to the church would have lapsed, as would pass under intestate distribution as there is no document governing the disposition of that property.

Under the default rules for intestate distribution, when there is no surviving spouse, which there isn't here because Mae was a widow, distribution to issue is on a "per capita" basis. Each of Mae's children would get an equal share of the intestate property. As Mae has two children, and 50% of her estate is passing by intestacy, D would get 25% of the total estate.

If on the other hand, the will is invalid, then all of Mae's estate would pass by intestacy. Just as above, the property would be distributed equally between her two children, and D would therefore get 50% of the estate.

Sam's Rights

Sam's rights to distribution will depend on whether the will is deemed invalid because of his undue influence or because it was not a proper holographic will.

If the will is valid, S is entitled to receive 50% of Mae's estate under the will. The other 50% that would not pass to the church because it is no longer in existence would pass through intestacy because of a lack of a residuary clause. Under intestacy, as discussed above for D, Sam would receive 50% of the property that passes in such a

manner, which would result in a 25% share of the total estate. Overall, if the will is deemed valid, Sam would receive 75% of Mae's estate.

If the will is not valid, then all of Mae's property would pass under intestacy, and S would receive half just the same as D above. Therefore, he would get 50% of Mae's estate.

Overall

Overall, the rights of D and S depend on whether the court finds that Mae had a valid will at the time of her death. If there was a valid will, S would receive 75% of his mother's estate, and D would receive 25%. If there was no valid will, then each S and D would receive a 50% share.

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ESSAY QUESTIONS AND SELECTED ANSWERS

JULY 2013

CALIFORNIA BAR EXAMINATION

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The answers were assigned high grades and were written by applicants who passed the examination after one read. The answers were produced as submitted by the applicant, except that minor corrections in spelling and punctuation were made for ease in reading. They are reproduced here with the consent of the authors.

Question Number	Subject
1.	Professional Responsibility
2.	Constitutional Law
3.	Community Property
4.	Contracts
5.	Wills/Trusts
6.	Remedies

Question 5

In 2000, Ted was married to Wilma, with whom he had a child, Cindy. Wilma had a young son, Sam, from a prior marriage. Ted typed a document entitled "Will of Ted," then dated and signed it. Ted's will provided as follows: "I give $10,000 to my stepson. I give $10,000 to my friend, Dot. I leave my share of all my community property to my wife. I leave the residue consisting of my separate property to my daughter, Cindy. I hereby appoint Jane as executor of this will."

Ted showed his signature on the document to Jane and Dot, and said, "This is my signature on my will. Would you both be witnesses?" Jane signed her name. Dot was about to sign when her cell phone rang, alerting her to an emergency, and she left immediately. The next day, Ted saw Dot. He had his will with him and asked Dot to sign. She did.

In 2010, Wilma died, leaving her entire estate to Ted.

In 2011, Ted married Bertha.

In 2012, Ted wrote in his own hand, "I am married to Bertha and all references to 'my wife' in my will are to Bertha." He dated and signed the document.

Recently, Ted died with an estate of $600,000, consisting of his one-half community property share of $300,000 in the $600,000 home he owned with Bertha plus $300,000 in a separate property bank account.

What rights, if any, do Bertha, Sam, Dot, and Cindy have in Ted's estate? Discuss.

Answer according to California law.

SELECTED ANSWER A

The issue is whether Bertha, Sam, Dot, and Cindy have rights, if any, in Ted's estate. In determining this, it is first critical to consider the validity of any of the testamentary documents executed by Ted.

Ted's 2000 Will

First, it is critical to consider whether Ted's executed will in 2000 is valid. To determine this we must consider whether there is (i) testamentary capacity, (ii) testamentary intent, and (iii) formalities have been met.

Testamentary Capacity

A testator must have legal and mental capacity.

First, legal capacity requires for the testator to be above the age of 18 at the time of executing the will. Here, Ted was married and had a child; therefore, presumably Ted was over the age of 18.

Second, mental capacity requires for minimum mental capacity test to be met. That is, the testator must (i) understand the nature of his bounty (his relationships), (ii) understand the nature of his assets, and (iii) understand the nature of his actions.

First, here, Ted likely understood the nature of his relationships, given that he described in the will his stepson, friend Dot, daughter Cindy, and his wife. Second, Ted likely understood the nature of his assets given that he gives $10,000 to his stepson and friend and leaves the shares of his community property to his wife. Third, Ted likely understands the nature of his actions given that he entitled the document that he typed "Will of Ted."

In short, the minimum mental capacity test is likely met.

Further consider whether Ted suffers from an insane delusion. Under this doctrine, a testator does not have capacity if suffering from a mental defect that causes the testator to suffer from an insane delusion, and but for such a delusion the document or provision of the testamentary document would not have been produced. Here, the facts do not indicate that Ted suffered from any mental defect or insane delusion.

In short, Ted has testamentary capacity.

Testamentary Intent

A testator must have present testamentary intent, which can be inferred from the document having material provisions and appointing an executory.

Here, Ted typed a document called "Will of Ted" and he set forth provisions distributing his property as well as appointing an executor. In short, Ted has testamentary intent.

It is critical to note whether there is any fraud, undue influence, mistake, or whether the will is a conditional or sham will. The occurrence of any of these instances may negate testamentary intent. The facts here do not suggest or reflect any incidence of fraud, undue influence, mistake, or the will being a conditional or sham will.

Thus, Ted has testamentary intent in executing the document.

Formalities

A will can either be a holographic or attested will.

For an attested will to be valid it must be in writing, signed by the testator, and also signed by at least two witnesses. Note, that the two witnesses must be in the presence of the testator (presence includes sight, hearing, etc.) when the testator signs the will or acknowledges his signature on a will; the witnesses must also understand that they are signing as witnesses to a will. Note, that witnesses need not sign the will in the

presence of the testator or in the presence of each other. Witnesses need only sign the will prior to the death of the testator.

Here, Ted typed the will, dated and signed it. Next, he showed his signature on the document to Jane and Dot and said, "This is my signature on my will. Would you both be witnesses?"

Jane signed her name, and Dot was about to sign when her cell phone rang, alerting her to an emergency, and she left. However, the next day, Ted saw Dot and asked Dot to sign the will and she did.

Given the facts above, here both witnesses were in the presence of the testator when he acknowledged his signature on the will and both witnesses signed the will prior to the death of Ted.

Thus, since the will is in writing, signed by the testator as well as at least two witnesses the will is valid.

Interested Witnesses

Witnesses who sign a will and are receiving a gift under the will are interested witnesses. Signing of a will by interested witnesses does not invalidate the will. Instead, a rebuttable presumption of undue influence/fraud applies to the interested witnesses; if the witnesses are not able to rebut the presumption then the gift fails and the witnesses would only get the amount from the testator that they would be entitled to under intestate succession. Note, however, that a person in the will given a fiduciary title or executory title is not an interested witness.

Here, Jane and Dot are the witnesses. Jane is appointed as the executor of the will and is, thus, not an interested witness as discussed above. Dot is a friend of Ted's and is granted $10,000 in the will and is an interested witness. As a result, the rebuttable presumption of undue influence/fraud applies to Dot. If Dot is unable to rebut the presumption, then the gift is invalidated and goes into the residue and Dot would only

take what she would receive under intestate succession, which would be nothing as Dot is only a friend of Ted and would not receive anything under intestate succession. If Dot was able to rebut the presumption then Dot will be entitled to the gift.

The facts here do not indicate whether there was any undue influence or fraud on behalf of Dot. Regardless, note that the interested witness problem may be cured by a republication by codicil (see below). If there is a valid codicil (see below), republication by codicil will apply and will cure the interested witness problem, which means that Dot will then be entitled to the $10,000.

Now that the 2000 will is valid, it is also critical to consider whether the 2012 note by Ted is a valid codicil.

2012 Note by Ted

The issue is whether the 2012 note by Ted is a valid codicil. A codicil is any writing that can accompany a will; note that an invalid codicil does not invalidate a will. Further note that a codicil must meet the same validity requirements as discussed above with respect to a will. That is, a codicil is valid if (i) testator has capacity, (ii) testator has intent, (iii) all formalities have been met.

Testamentary Capacity

See rule above.

First, regarding legal capacity, see above.

Second, regarding mental capacity, in 2012, Ted wrote “I am married to Bertha and all references to my wife in my will are to Bertha.” Such writing reflects that Ted understood the nature of his action, relationship, and assets as he refers to his will and clarifies the term “to my wife” to be Bertha, the woman he married after Wilma’s 2010 death.

In short, the facts support that Ted had testamentary capacity.

Testamentary Intent

See rule above.

Here based on the statements in the writing there appears to be testamentary intent. Furthermore, the facts do not indicate any fraud, undue influence, or mistake.

Formalities

A holographic codicil must be in writing and signed by the testator. Note that the writing may occur on any paper or surface.

Here, Ted wrote in his own handwriting "I am married to Bertha and all references to 'my wife' in my will are to Bertha."

Given that the codicil was signed and in Ted's handwriting, the codicil is valid.

In summary, the 2000 will and the 2012 codicil are both valid.

Integration

Integration entails that all documents in physical and legal connection will be read together at the testator's death.

Here, the 2000 will and the 2012 codicil are valid and have a legal connection to one another. Therefore, both will be read together.

Distribution of Ted's Estate

Upon Ted's death, his estate consisted of his one-half community property share of $300,000 in the $600,000 home he owned with Bertha plus $300,000 in a separate

property bank account. Ted's estate should be distributed as follows.

$10,000 to Stepson

Ted's 2000 will states, "I give $10,000 to my stepson." This is a general gift; a general gift is a gift that can be satisfied by the general estate.

Here, Ted's stepson is presumably Wilma's young son Sam. Note that if there are any ambiguities in a will, the court will consider extrinsic evidence clarifying any ambiguities (whether latent or patent ambiguities). Here, the court will likely consider that Ted's prior marriage to Wilma, who had a young son Sam from a prior marriage. Therefore, even if any opposing arguments are made to contest this interpretation, it is likely that the court will find that Sam was Ted's stepson, as there is no evidence to the contrary.

Given that the 2000 will is valid and the 2012 codicil has not revoked or amended the will with respect to the general gift to the stepson, the stepson is entitled to $10,000 from the $300,000 separate property bank account.

$10,000 to Dot

As discussed above, at the time of execution of the 2000 will Dot was an interested witness. However, as discussed above, the 2012 codicil was valid and therefore republication by codicil took into effect. When republication of codicil occurs, it cures any interested witness problems; this means that the court will only consider now whether there was any interested witness at the time of the 2012 codicil instead of the 2000 will.

As a result, the republication by codicil cures any interested witness issues and Dot will be entitled to receive the $10,000 gifted to her in Ted's will. This $10,000 is a general gift for the same reasons as discussed with regards to the gift to the step-son. Thus, the $10,000 will be satisfied from the $300,000 separate property bank account.

Community Property to "My Wife"

Here, the 2000 will devises all of Ted's "community property to his wife." Furthermore, in the 2012 codicil Ted wrote "I am married to Bertha and all references to my wife in my will are to Bertha."

Note that the court will likely consider the 2012 reference of "my will" as an act of incorporation by reference. A testator may incorporate by reference any document so long as that document is existing and it is described sufficiently and the testator so intends. Here, by referring to his "will" Ted is incorporating his will by reference. Since the will existed at the time of the codicil and the codicil was specific in referencing the will, the court will likely presume that Ted intended to incorporate the will.

Furthermore, as discussed above, the court will consider extrinsic evidence if there is any ambiguity in any testamentary document. Thus, the court will consider the codicil as well as the fact that in 2011 Ted married Bertha after Wilma had died in 2010.

In short, whether by incorporation by reference or by considering extrinsic evidence, the court will find that the statement "to my wife" is intended to identify "Bertha."

As a result, the codicil and the will together, Bertha is entitled to Ted's one-half community property share of $300,000 in the $600,000 home Ted owned with Bertha.

Residual Estate to Cindy

A residual gift is a gift of anything remaining after the distribution of the estate.

Here, Ted's 2000 will states "I leave my residue consisting of my separate property to my daughter Cindy."

As this is a residual gift, Cindy gets whatever remains in the residual estate. That is, after deducting the $20,000 paid to Sam and Dot, Cindy, Ted's daughter, is entitled to $280,000 of the separate property bank account.

In conclusion, Bertha, Sam, Dot and Cindy have rights in Ted’s estate as described above.

SELECTED ANSWER B

For convenience: Ted = T, Wilma = W, Sam = S, Dot = D, Jane = J, Bertha = B

a. Is T's 2000 Will Valid?

The rights of the respective parties will depend on whether T's 2000 will is valid.

Capacity

In order to make a valid will, a testator must have the capacity to do so. A testator has capacity when he is over the age of 18, understands the nature and extent of his property, understands the natural objects of his bounty (his relationships), and understands the nature of the testamentary act.

Here, T is married, and is thus presumably over 18. Additionally, he drew up a document purporting to be his will, entitling it "Will of Ted," and made dispositions of his property, mentioning cash and community property. He left gifts to his friend, his stepson, his wife and his daughter. Therefore, it can be said that he knew the extent of his property, his relations with others, and the nature of the testamentary act. Therefore, T had capacity to make this will.

Present Testamentary Intent

A testator must also have the present intent to make the will effective upon his death. Here, because of the reasons above, and the fact that he had Dot and Jane sign it as witnesses, likely satisfies T's intent to make this will effective. Therefore, present testamentary intent is satisfied.

Attested Will Validity

An attested will is a witnessed will. In order to be valid, the will needs to be in a writing, signed by the testator, the signature was either done in the joint presence of 2+ witnesses or acknowledged in the joint presence of those witnesses, the witnesses both sign during the testator's lifetime, and the witnesses understand that they are witnessing a will.

Here, T drafted an instrument purporting to be his will, dated and signed it. Additionally, he approached Jane and Dot, while they were both together, and said "This is my signature on my will. Would you both be witnesses?" Therefore, he acknowledged his signature on his will written within the joint presence of 2+ witnesses.

However, after he acknowledged the signature, only Jane signed immediately. Dot did not sign until the next day. However, for attested wills the witnesses do not need to both be present when one another sign; they just both need to be present when T acknowledges his will. Therefore, this requirement was satisfied, and Dot validly signed it as a witness the next day.

Because both witnesses signed in T's lifetime, both witnesses were present when T acknowledged his signature, and they both understood they were witnessing his will by T's statement and identification of the instrument.

Therefore, this was a valid attested will.

Interested Witness Problem

A witness is deemed to be interested if they are a witness to the will and also take under the will. However, this does not affect the validity of the will for lack of witnesses but has an impact on the interested witnesses' gift. Therefore, even though D takes under the will, she can still be a witness. Her gift will be discussed below.

Additionally, while J is also a witness and named in the will, she is not an interested witness since she is only named in an executor capacity.

Holographic Will

A will can be valid as a holographic will if all material terms are in the testator's handwriting, and the testator signs the will. All material terms refer to the naming of gifts and beneficiaries. Here, this writing was all typed and not in T's own handwriting. Therefore, this would not be a valid holographic will.

Terms of Will

Since the 2000 will is valid, the disposition of T's estate will be pursuant to it unless it is otherwise altered or revoked. The terms are as follows:

$10,000 to his stepson

$10,000 to D

All of my share in community property to T's "wife"

Residue to J.

b. Rights of Bertha

Under the will, all of T's interest in community property was to go to "his wife." T has $300,000 of a community property interest in the house he owned with Bertha. Bertha will argue that this allows her to take his share of the community property for two reasons:

Is the reference to "my wife" an act of independent significance

A will can allow the completion of a gift to be made based on an event to be happening in the future. This is called an act of independent significance. The requirements for a valid act of independent significance are that the event has an independent significance outside of the wills making process.

Here, T stated that his share of community property would go to "his wife." Therefore, this gift is conditional on T having a wife at his death. Because marriage is separately significant from the wills making process, this is a valid gift conditioned on an act of independent significance, and will allow B to take the $300,000 community property interest.

Valid Codicil

A codicil is an instrument that amends, alters, or revokes a will. In order for it to be valid, it needs to comply with the formalities required for wills.

Here, B will argue that T's 2012 handwritten note that identifies B as T's wife under the 2000 will is a valid codicil allowing her to take the community property share in the house. Thus, the validity of this instrument depends on its compliance with formalities.

Attested Will

See the rules for attested wills above. This instrument would not qualify as an attested will because it is not witnessed. Therefore, it cannot be a valid testamentary instrument on this basis.

Holographic Will

See the rules regarding holographic wills above. Here, this was signed by T and was in his own handwriting. It describes that all references in his will are to B. Therefore, all material terms are set out, and in T's own handwriting. Therefore, this is a valid holographic codicil.

Incorporation by Reference

A testamentary instrument is allowed to refer to an instrument to complete the gifts if the instrument clearly refers to a written document, that document is in existence at the time of execution of the instrument, and it was the testator's intent for the document to be incorporated into his will.

Here, in the 2012 instrument, T clearly identified his prior will, that will was already in existence, and it was T's intent to incorporate the will into this current instrument as he uses the instrument to explain that all references are to B. Therefore, his prior will was validly incorporated to complete the gift in the 2012 instrument.

Therefore, B will take T's $300,000 community property interest in the home.

c. Rights of Sam

The 2000 will makes a gift to T's "stepson," of $10,000. However, T's stepson is not identified by the instrument.

Ambiguities

At common law, parol evidence (evidence outside of the will) was not allowed to correct a patent defect under the will. Parol evidence was only allowed to cure latent ambiguities. A will was patently defective if the identity of a beneficiary cannot be ascertained.

Here, the gift only mentions T's stepson, which would seem to be S, but since T is no longer married to Wilma from her death, and it does not appear B has any son of her own from a prior marriage, it is unclear if there is a stepson any more. Therefore, under common law, this gift would fail for lack of an identifiable beneficiary.

However, CA allows all parol evidence in to clear up any ambiguities, whether latent or patent, in order to more closely effectuate the intent of the testator.

Therefore, S will be able to introduce evidence that he was, when the 2000 will was drafted, T's stepson, and it was T's intent that the gift should go to S. This evidence will likely be properly admitted by the court to allow the gift to pass to S.

Therefore, S will likely take the $10,000.

d. Rights of D

Under the 2000 will, D will claim a gift of $10,000.

Interested Witness Problem

The issue presented is that D was a witness to the 2000 will as well as a beneficiary. If a witness to the will is also a beneficiary, there is a rebuttable presumption that the witness exercised undue influence in the drafting process. If the witness is a relative, they are still allowed to take the gift up to what their intestate share would have been; however, non-relatives, who would not have an intestate share, do not take at all.

Here, D is a non-relative since she is specifically listed as T's friend. Therefore, if she is unable to rebut the presumption, she would take nothing under the will. She can rebut this presumption by showing with clear and convincing evidence that there was no undue influence. Here, there are no facts suggesting that D procured her gift improperly: T typed up the will on his own, later executed a codicil as discussed above without validating the gift to D, and there was nothing said by D regarding her gift when T asked her to sign. Therefore, the presumption is likely rebuttable, and D can take her $10,000 gift even as an interested witness.

Republication by Codicil

When a valid codicil is executed, it updates the date of execution of the will to the date

that the codicil was executed. Here, as discussed above, T had executed a valid codicil in 2012. Thus, the will has been republished by codicil. Additionally, because it was deemed to be a re-execution of the will, any prior interested witness problems with the will are cured unless the interested witness was also a witness to the codicil who takes a new gift under the codicil.

Here, as discussed above, T executed a valid codicil in 2012, and this codicil was holographic. D did not witness this instrument, nor was she named in it. Therefore, this has been a republication which cured the interested witness problem posed by D being a witness and a beneficiary under the 2000 will.

Therefore, even if D could not rebut the presumption of undue influence, she will take her $10,000 gift because of republication by codicil.

e. Rights of C

As discussed above, S will get $10,000, D will get $10,000, and B will get T's $300,000 community property interest. Therefore, there is $280,000 left undisposed in T's estate.

The leftover of an estate that is disposed of by will is referred to as the residue. Unless there is a direction of disposition, the residue is distributed by intestate succession. However, a testator can include a residue clause which leaves the residue of his estate to an identified beneficiary.

Here, T set out that the residue of his estate was to go to his daughter C. Therefore, C is a residuary beneficiary, and thus will be able to take the $280,000 not specifically disposed of under the will.

Therefore, C gets $280,000 out of T's $300,000 separate property.

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ESSAY QUESTIONS AND SELECTED ANSWERS

FEBRUARY 2015

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Question Number	Subject
1.	Contracts
2.	Real Property
3.	Civil Procedure
4.	Remedies
5.	Business Associations
6.	Wills/Trusts

QUESTION 6

In 2011, Tess, age 85, executed a valid will, leaving all her property in trust for her grandchildren, Greg and Susie. Income from the trust was to be distributed to the grandchild or grandchildren then living each year. At the death of the last grandchild, any remaining assets were to go to Zoo for the care of its elephants.

In 2012, the court appointed Greg as conservator for Tess, because of Tess's failing mental abilities.

In 2013, the court authorized Greg to make a new will for Tess. Greg made a new will for Tess leaving Tess's entire estate to Susie and himself outright. Greg, without consulting Tess, then signed the will, in the presence of two disinterested witnesses, who also signed the will.

In 2014, Tess found a copy of the will drafted by Greg, and became furious. She immediately called her lawyer, described her assets in detail, and instructed him to draft a new will leaving her estate in trust to Susie alone and excluding Greg. Income from the trust was to be distributed to Susie each year. At Susie's death, any remaining assets were to go to Zoo for the care of its elephants. The new will was properly executed and witnessed.

In 2015, Tess died. That same year, Zoo's only remaining elephant died.

Zoo has petitioned the court to modify the trust to provide for the care of its animals generally.

1. Is Zoo's petition likely to be granted? Discuss.

2. What rights, if any, do Greg, Susie, and Zoo have in Tess's estate? Discuss. Answer according to California law.

QUESTION 6: SELECTED ANSWER A

1. Zoo's Petition to Modify the Trust

Trust Creation

The issue is whether Tess's will created a valid charitable trust. A trust may be created either inter vivos or by testamentary trust in a will. A trust is created when there is a present intent to create a trust, a trust beneficiary, a trustee, a trust res, and a valid trust purpose. Here, it appears that Tess intended to create a trust via her will and that her property was the trust res. Although Tess did not name a trustee, a court will ordinarily appoint an appropriate trustee rather than allow a trust to fail for lack of trustee. The trust has appropriate beneficiaries because the portion of the trust intended for the benefit of Tess' grandchildren has identifiable and ascertainable beneficiaries, and the valid trust purpose of supporting the grandchildren from the income.

A charitable trust is a trust for a public charitable purpose, such as health care, education, or religion. A charitable trust may be of perpetual duration and need not identify ascertainable beneficiaries. In addition, the doctrine of cy pres applies to charitable trusts. When a charitable purpose becomes impossible or impracticable, under the doctrine of cy pres the court will determine whether there is an alternative charitable purpose that comes as near as possible to the settlor's charitable intent or whether the settlor would prefer the trust to fail. Here, the remainder of the trust after the death of the grandchildren is a charitable trust because the assets are to go the Zoo for the care of the elephants. Because the elephants died after Tess's death, her express charitable purpose of caring for the elephants is no longer possible. However, it is likely that the court will apply cy pres to direct the trust to the Zoo for the care of other animals or to another zoo with elephants for their care. It is not clear that Tess had a specific connection to this Zoo or to elephants in particular during her lifetime, such that she intended the trust to remain valid only if Zoo took care of elephants with the money. Rather, it appears that she had a general charitable intent, and the court will direct the trust funds to the charitable purpose as near as possible to her intent. Accordingly, Zoo is likely to be able to modify the trust under the cy pres doctrine.

(The gift to the Zoo does not fail under the Rule Against Perpetuities because it vests in the Zoo within 21 years after a life in being at the time of the creation of the trust. Under the Rule Against Perpetuities a gift will fail if it need not vest within the time of a life in being plus 21 years. The grandchildren were lives in being and the trust passes to the Zoo immediately upon the death of the last grandchild. Therefore, the gift over to the Zoo does not violate RAP. The charity-to-charity exception does not apply because the grandchildren are not a charity.)

Conclusion

The court will likely grant Zoo's petition to modify the trust to provide for the care of its animals generally under the doctrine of cy pres.

2. Rights to Tess's Estate

Validity of 2013 Will

The issue is whether the 2013 will validly revoked Tess's 2011 will. Generally, a validly executed will may be revoked by an act of physical revocation or by the execution of a subsequent valid will that either expressly revokes the earlier will or is inconsistent with the terms of the earlier will. If it is inconsistent in terms, the earlier will is revoked only to the extent of the inconsistency. The later will must be validly executed with all of the required formalities. A will is validly executed when there is testamentary capacity, present testamentary intent, the will is in writing, the will is signed by the testator (or signed at her direction and in her presence), there are two witnesses who jointly witness the signature or affirmation of the signature, and the two witnesses sign the will before the death of the testator with knowledge that it is the will they are signing. If the witnessing formalities are not observed, it may nonetheless be considered a valid will if the will proponent provides clear and convincing evidence that the testator intended the document to be her will. Holographic wills are permitted in California if all material terms are in the testator's handwriting.

Here, Tess executed a valid will in 2011 pouring her property into a trust that was created by the terms of the will. In 2013, Greg attempted to revoke the earlier will by

making a new will that was inconsistent with the earlier will by making an outright gift of all of the property. Thus, the 2011 will was properly revoked if the formalities were observed by the 2013 will. Because the court appointed Greg as conservator and authorized him to create a new will for Tess, Greg's capacity and present intent to create the will are at issue. No facts indicate that Greg did not have capacity or that he did not presently intend to create the will in 2013. The will was in writing and Greg signed it on behalf of Tess. Although Tess did not direct that he sign the will (and indeed she was not even aware of it), Greg had been appointed conservator and so he was authorized to sign on her behalf. The will was signed in the joint presence of two disinterested witnesses, and they also signed the will before Tess's death. Thus, all of the formalities were observed and the 2013 will became Tess' valid will, revoking the 2011 will by implication.

Undue Influence or Abuse of Relationship

The issue is whether the will or some portion of it was invalid because Greg exerted undue influence or abused his conservatorship in some way. Undue influence occurs when a person exerts influence over a testator to the extent that the testator's free will is overcome. If that happens, the portion of the will that was made because of the undue influence is invalidated. If that portion was made to a person who would take by intestacy, the gift is invalidated only to the extent of the intestate share. Undue influence is presumed where a person is in a confidential relationship with the testator, had a role in procuring the will, and an unnatural gift results. Here, Greg has not exerted undue influence over Tess because he did not need to prevail on her to change her will. Instead, he was appointed conservator and given authority to change the will himself. Thus, the gift will not be invalidated because of undue influence.

However, the court might decide that Greg abused his position as conservator by changing the will in a way that was contrary to Tess's intent, without ever consulting her as to her wishes. A conservator generally has fiduciary-like duties to the individual he is representing, and thus he must act loyally and in her best interests. Greg's change of the will benefitted him directly, in a way directly contrary to Tess's express wishes at a

time when she had mental capacity. Thus, the court might find that Greg's conduct violated his duty to loyally represent Tess's interests. In that case, his gift would likely be reduced to his intestate share. However, if Tess's property passed by intestacy, it would go equally to Susie and Greg as Tess's only living heirs. This is exactly the will that Greg made. Therefore, Greg would receive the gift he gave himself when he was abusing his authority. In that case, the court might impose a constructive trust on Greg's property for the benefit of Zoo.

(In practical effect, Greg's wrongdoing does not matter because Tess was able to execute a valid will revoking his 2013 will, see below.)

2014 Will

The issue is whether Tess's 2014 will properly revoked the 2013 will created by Greg. As stated above, a will is created when there is present testamentary intent, testamentary capacity, a will in writing, signed by the testator, witnessed by two joint witnesses, and signed by the witnesses before the testator's death.

Testamentary capacity exists when the testator understands the nature and extent of her property and knows the natural objects of her bounty. Here, when Tess called her lawyer in 2014 she was able to describe her assets in detail and provide a reasonable explanation for leaving her assets entirely to Susie. Although Greg will argue that she lacked capacity because he had been appointed conservator in light of Tess's failing mental abilities, testamentary capacity may exist even when the testator lacks capacity to manage his finances and other personal affairs. Under the circumstances, it appears that Tess had capacity to understand her assets and who she wanted to leave them to, and the court will likely find that she had capacity.

Tess also appeared to have present testamentary intent because she instructed her attorney to draft a new will. The facts also state that the will was properly executed and witnessed. Therefore, the 2014 will validly revoked the 2013 will because it was completely inconsistent with that will.

Accordingly, at Tess's death in 2015, the 2014 will leaving her entire estate in trust with income distributed to Susie during her lifetime and remaining assets to the Zoo at the time of Susie's death was Tess's valid will.

Omitted Child

Greg might attempt to argue that he is entitled to an intestate share of Tess's estate as an omitted child. If a child born after the creation of a will (or the testator mistakenly believed the child was dead or did not know he had been born) is unintentionally omitted from the will, the child may take his intestate share and all other gifts are abated. However, Greg is a grandchild not a child, and he was alive at the time the will was made and intentionally omitted because Tess was angry that he had attempted to change her will. Thus, Greg will not be entitled to an intestate share as an omitted child.

Remainder to Zoo

As noted above, the gift to Zoo after Susie's death does not violate the Rule

Against Perpetuities. It is a valid charitable trust, and the court will likely apply cy pres to prevent the trust from failing.

Conclusion

Greg has no rights in Tess's estate. Susie has a right to income from the trust during her lifetime and Zoo has a right to distribution of the trust assets upon Susie's death.

QUESTION 6: SELECTED ANSWER B

1. Zoo's Petition.

The Issue here is whether Tess created a valid will and trust that left Zoo any interest in T's property.

2011 - Will

A valid will must be in writing. It must be signed by the testator in the presence of two disinterested witnesses at the same time who also sign the will.

The facts state that T created a valid will, so we can assume she met all elements of the will. Therefore, a valid will was created.

Trust

T left all of her property in trust for her grandchildren. In order for a trust to be valid, there must be a testator, a beneficiary, trustee, trust purpose, and trust property.

Testator

Here, T is the testator.

Beneficiaries

T's grandchildren Greg and Susie are the income beneficiaries b/c they get the income from the trust. The Zoo is also a beneficiary and they hold a future interest in the property. The Zoo will get the remainder of the trust after the last grandchild dies.

Trustee

Although there isn't a named trustee, it doesn't defeat the trust. The court will appoint a trustee if there is no trustee to manage the trust.

Trust Purpose

The purpose of the trust is to provide income to the grandchildren for their lives, then the remainder goes to the zoo.

Trust property

T has left all of her property into the trust.

Therefore, a valid trust was created. Under the 2011 will, Zoo had an interest in T's trust.

2013 - New Will

The issue is whether the new will is valid b/c it was created by a court appointed conservator.

Will Formalities

See rules above.

Here, Greg as the conservator for T and under the court's authorization created a new will for Tess. The will was signed by two disinterested witnesses. However, T did not sign the will. But Greg will argue that as the conservator, he was permitted to sign on her behalf. So, technically, a will was properly created. However, I will discuss below why the will should be void.

Greg as Conservator

A court can appoint a guardian or conservator to act on behalf of a person who lacks the mental capacity to act on their behalf. They have the authority to make legal decisions, such as drafting a new will. However, a conservator still owes the testator a fiduciary duty of care and loyalty. The conservator must act in the best interest of the testator and not make any decisions that are self-serving and are directly adverse to T's interest.

Here, Greg was appointed as a conservator for T b/c of her "failing mental abilities." Although he is authorized to create a new will for T, he must uphold his fiduciary duties. Greg violated his fiduciary duties when he created T's new will without first talking to her about the will and determining whether she was okay with changing the will so that it left the entire estate to Greg and Susie. Instead, Greg disregarded her previous will and left the entire estate himself and his sister Susie, cutting the Zoo completely out of the will. The act of leaving everything to himself and his sister shows self-dealing and he has violated his duty of loyalty. Even though he was legally permitted to create a new will for Tess, he violated his fiduciary duty to T. Any attempt Greg makes to argue that he was within his right to draft the new will will fail b/c he violated his fiduciary duties. T's estate could sue Greg for violating this duties and seek a request to void the 2013 will.

Undue Influence

Additionally, the Zoo and T's estate will argue undue influence per se b/c there was a fiduciary relationship with the person who wrote the will and there was an unnatural devise.

Here, Greg is the conservator and in a fiduciary relationship with T. The devise was also unnatural b/c the original will never intended to leave the entire estate to Susie and Greg. Therefore, the Zoo and T's estate should be successful in voiding the will under undue influence per se.

DRR

Alternatively, the Zoo and T's estate could attempt to revive the original will under DRR.

Under DRR, a previous will can be revived if a most recent will was created under fraud or misrepresentation. Meaning that the testator created the new will because they were misinformed about something (i.e., a beneficiary had died when they were really alive). If that is the case, then the new will can be voided and the old will can be revived.

Here, T's estate and the Zoo will argue that T would have never created the new will that Greg created. Greg fraudulently misrepresented T's wishes for her will and created an unnatural devise. As discussed above, T never intended to leave her entire estate to Greg and Susie. There is nothing in the facts that suggests she had changed her mind since 2011. Therefore, the 2013 will should be voided and the 2011 will should be revived.

2014 Will Drafted by Lawyer

After T discovered that Greg created the 2013 will, T created a new will. The issue here is whether a valid will was created for lack of capacity.

Will Formalities

See rule above. Here, the facts state that the new will was properly executed and witnessed. So, let's assume that will formalities have been met.

Lack of Capacity

Generally, a person lacks capacity if they are unable to understand the nature of their estate, the nature of their relationship with family and friends, and the nature of their act of creating the will.

Here, the biggest problem is that the court appointed a conservator for T b/c of her failing mental abilities. Other than that, we don't know much about her capacity to create a will. We don't know if "failing mental abilities" equates to lack of capacity. Let's look at the elements for capacity.

Nature of the act

This element means that the T must understand the nature of her acts and conduct of creating the will.

Here, T appears to understand the nature of her act of creating the will because she saw the will that Greg drafted and became furious and contacted her lawyer to draft a new will. It appears that T understood the nature of her act b/c she knew that Greg's 2013 will was not what she intended and she knew that she needed to call her lawyer to draft a new will. Therefore, this element is met.

Nature of the estate

This elements means that the testator must understand the extent of and identify his property.

Here, T understand the nature of her estate and property b/c she revised her will describing her assets in detail and left her entire estate to Susie. Thus, this element is likely met.

Nature of relationships with family and friends

This element means that the testator must understand their relationship with family and friends - the people they are leaving their assets to.

Here, T seems to understand the nature of her relationships b/c she was so angry at Greg for what he did that she specifically excluded him from her new will. She left all of estate in trust to Susie with the remainder to the Zoo. Thus, this element is likely met.

Therefore, since T appears to have met all the elements for capacity at the time that she created the will, the 2014 will is probably the valid enforceable will. The 2014 will revokes all prior wills automatically. If the court agrees that T had capacity at the time that she created her will, then T's 2014 will is probably valid and Zoo has an interest in T's estate.

Cy Pres

The next issue is Zoo's ability to use the assets b/c the trust assets were left for the care of its elephants but they have no elephants. Under the Cy Pres doctrine, the court can modify a charitable trust purpose if the trust purpose has been frustrated.

Here, T's trust left anything remaining in the trust to Zoo for the care of its elephants. The facts don't indicate that Susie has died yet, so the Zoo's interest is still a future one. Because the Zoo doesn't have any present interest in the trust, the Zoo will most likely fail in petitioning the court to modify the trust purpose. Although the Zoo doesn't have any elephants at this time, they might have elephants when Susie dies. If at the time that Susie dies, the Zoo doesn't have elephants, then the Zoo might have a better chance at succeeding in modifying the trust purpose. If they are successful in modifying the trust purpose, the new purpose must also be charitable and the court will probably want them to keep the charitable purpose as close as possible to what the original trustor intended the purpose to be. Therefore, Zoo's petition is premature. The court should dismiss it at this time b/c they do not have any present interest and the purpose of the trust is not currently frustrated.

2. Rights of Greg, Susie, and Zoo.

See discussion above regarding the beneficiaries' rights.

Disposition

Greg

Based on the 2014 will, Greg has no interest in T's assets. Of course, if the court determines that T lacked capacity to create the 2014 will, then Greg might be able to income from the trust from the 2011 will. The 2011 will will only be valid, if the 2013 will that Greg fraudulently created is void and the 2011 will is revived.

Susie

Susie has interest in the trust income for her life under the 2014 will. As discussed above, the 2013 will is likely invalid, so Susie won't get share T's entire estate with Greg. If the court determines that the 2014 will is invalid, then Susie gets trust income for life under the 2011 will.

Zoo

Zoo has a future interest in the remainder of the trust for the care of its elephants under the 2014 will.