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Impact of AB 205 on Debt Collection in California

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Authors

Sears, Brad

Badgett, M V Lee

Publication Date

2003-08-01



BRAD SEARS
THE CHARLES R. WILLIAMS PROJECT
ON SEXUAL ORIENTATION LAW
PHONE (310) 267-4382
E-MAIL WILLIAMSPROJECT@LAW.UCLA.EDU

SCHOOL OF LAW
BOX 951476
LOS ANGELES, CALIFORNIA 90095-1476

Memorandum

To: Assemblymember Jackie Goldberg
From: Professor Brad Sears, UCLA School of Law
Professor M.V. Lee Badgett, University of Massachusetts at Amherst
Date: August 29, 2003
Re: Impact of AB 205 on Debt Collection in California

I. Executive Summary

This memo, co-authored by UCLA's Williams Project on Sexual Orientation Law and the Institute for Gay and Lesbian Strategic Studies (IGLSS), is a response to your request for an estimate of the impact of AB 205 on the ability of California businesses to collect debt at risk of default. We estimate that AB 205 will reduce California businesses' losses from uncollected debt. AB 205 will provide creditors with enhanced ability to collect between \$13 and \$78 million dollars of at-risk debt held by registered domestic partners in California.

If AB 205 is enacted domestic partners will have community property, and such property will be liable for the debts of either partner, whether incurred before or after the partnership was registered and regardless of which partner has management and control over the property. In addition, for debts incurred to provide one partner with the necessities of life, the other partner's separate property will be liable. In short, domestic partners will be financially accountable for each other just as married persons.

I. INTRODUCTION

This memo presents our analysis of AB 205's impact on debt collection in California. AB 205, if enacted, would give couples who are registered as domestic partners almost all of the rights and obligations as spouses. Since marriage creates mutual obligations for debt, AB 205 could have an impact on debt collection in California. Based on the analysis set out in this memo, our best estimate is that AB 205 will provide creditors with enhanced ability to collect between \$13 and \$78 million dollars of at-risk debt held by registered domestic partners in California.

In estimating the impact AB 205 will have on the ability of businesses to collect debt, one important variable is, of course, the number of couples who are likely to register as domestic partners if AB 205 is enacted. California currently allows same-sex couples to register as domestic partners. Different-sex couples are also allowed to register as long as one member of the couple is at least 62 years of age. As of May 14, 2003, 19,905 couples had registered as domestic partners with the State. Unfortunately, the State does not track how many couples registering are same-sex or different-sex. In this analysis, we assume that most domestic partners are same-sex couples. This assumption is reasonable given the fact that different-sex couples are legally allowed to marry and persons over 62 are less likely to form non-marital, co-habiting relationships.

Further, for the purpose of this analysis, we assume that the number of couples wanting to remain registered as domestic partners under AB 205 will remain roughly the same as the current level of registration, at least in the near future. By providing a more comprehensive set of legal rights and obligations than afforded under current law, AB 205 will create an incentive for some couples to register as domestic partners. However, it is possible that this more comprehensive set of rights and obligations will also deter some couples from registering and may lead some

registered couples to terminate their domestic partnerships. We have no way of knowing how much these two effects might offset each other; therefore, it is not possible to precisely predict whether domestic partnership registrations will increase or decrease if AB 205 is passed.

Because of the uncertain impact of AB 205 on the number of couples registering, we do not build in any assumptions about the rate of increase in partnerships created by AB 205 in the near future.¹ In short, for purposes of this analysis, we assume that the number of registered domestic partnerships will remain at 19,905 once AB 205 is enacted. We assess the impact of AB 205 on the ability of California businesses to collect debt using the most recent data available for each factor that we analyze.²

II. ANALYSIS

AB 205 will help California's businesses by making it easier for them to collect debts from consumers and mortgagors. AB 205 will have this result by imposing liability on individuals for the debts of their domestic partners in the same way that individuals are currently held liable for their spouse's debts under California law.

California is a community property state and employs a system for liability for marital debts "that is most favorable to creditors."³ A married couple's community property⁴ is liable for a debt⁵ incurred by either spouse, no matter whether that debt was incurred before or during marriage. Liability also applies to community property regardless of i) which spouse has management and control of the property, ii) whether one or both spouses are parties to the debt,⁶ and iii) whether the debt was incurred for benefit of the couple or just for the benefit of one spouse exclusively.⁷

While generally the separate property of a married person is not liable for debt incurred by a spouse before or during marriage,⁸ even separate property is liable for a debt incurred by an individual's spouse for "necessaries of life."⁹ This rule codifies spouses' financial obligation to provide for one another. Of the possible approaches to liability for marital debts, California's approach gives creditors "the greatest assurance that debts of the spouses will be satisfied."¹⁰

Under AB 205, creditors will also have the same increased ability to recover debts from individuals who are in registered domestic partnerships. Under AB 205, domestic partners will have community property, and that community property will be liable for their partners' debt, regardless of whether the debt was incurred before or after the formation of the domestic partnership, regardless of who has management and control over the community property, and regardless whether one or both partners are parties to the debt. Under AB 205, even a domestic partner's separate property will be liable for debts incurred to provide for the basic life needs of his or her partner. In short, domestic partners will have the same financial accountability to their partners, and their partners' creditors, as spouses.

It is not possible to precisely quantify how much more debt that California businesses will be able to collect under AB 205. Quantifying that amount would require detailed information specific to each registered couple, such as their debts, their inability to pay such debts as individuals, the property that is currently held by them that would be considered community property under AB 205, and the capacity of such property to cover outstanding debt. Such detailed data does not exist.

We can, however, estimate the total amount of debt held by people in registered domestic partnerships in California. In the United States, total outstanding household home mortgage debt is roughly \$6.23 trillion, and total outstanding consumer credit debt is roughly \$1.78 trillion.¹¹

The per capita consumer debt (credit card plus mortgage debt) is approximately \$28,000.¹² The 19,905 registered domestic partnerships in California, therefore, have approximately \$1,114,680,000 in consumer debt.¹³

Of course, only a portion of this total amount of debt will be at-risk of default, thereby creating a potential need for creditors to take advantage of the enhanced ability to collect debt from registered domestic partners under AB 205. We can use several measures to determine the amount of at-risk debt that will be made more secure by AB 205.

- **Debt-burden ratio** -- The Federal Reserve Board has defined as an indicator of debtor distress the proportion of families with unusually large total payments relative to their incomes, specifically the proportion of debtors with payments exceeding 40% of their incomes. In 2001, 11% of families with debts fell into this category.¹⁴ Using this measure, AB 205 would provide an enhanced ability to collect on \$122,614,800 of at-risk debt from domestic partners. However, this measure is likely to overestimate the amount of debt at risk of default, because some of these families might be more than capable of carrying or decreasing this level of debt burden.
- **Delinquency Rates**—Another measure used by the Federal Reserved Board to identify debt repayment problems is the percentage of families who report that they have been sixty or more days late in their payments during the proceeding year. In 2001, 7% of families reported such delays in the payment of debts.¹⁵ Using this measure, AB 205 would provide creditors with an enhanced ability to collect on \$78,027,600 of at-risk debt.
- **Foreclosure/Charge-Off Rates** – A more conservative measure of at-risk debt is debt for which creditors have already take some action to discharge or collect -- either by

determining that credit-card debt is uncollectible (charge-off rate) or by foreclosing on mortgages (foreclosure rate). During the second quarter of 2003, the charge-off rate for credit card debt was 6.97%.¹⁶ During the first quarter of 2003, the foreclosure rate was 1.2%.¹⁷ Using these measures, AB 205 would provide creditors with an enhanced ability to collect on \$27,792,660 of at-risk debt.

- Bankruptcy Rates** -- A final, and more conservative measure of debt re-payment problems, is bankruptcy filings. In 2002, the households per bankruptcy filing rate for California was 85.5.¹⁸ In other words, 1.2% of households in California filed for bankruptcy. Using this measure, AB 205 would provide an enhanced ability to collect on \$13,376,160 of at-risk debt.

Table I: Estimates of Total Amount of Debt at Risk of Default Held by Registered Domestic Partners in California

	% of Households, Families, or Debt	Total Amount of Debt At Risk of Default (millions)
Debt Payments Exceeding 40% of Income	11	\$122.6
Over 60 Days Late on A Payment During Past Year	7	\$78.0
Foreclosure/Charge Off Rate	7/1.2	\$27.8
Bankruptcy Rate	1.2	\$13.4

Thus, using the most conservative estimates, those based on an actual delinquency in the payment of debt, AB 205 will provide creditors with enhanced ability to collect between \$13 and \$78 million dollars of at-risk debt held by registered domestic partners in California.

III. CONCLUSION

AB 205 will increase the ability of California's businesses to collect unpaid debt by making domestic partners responsible for their partners' debts on the same basis as spouses under

California law. Creditors will have increased ability to collect \$13 - \$78 million of debt at risk of default held by registered domestic partners in California.

¹ Over a longer period of time, we predict that the new rights and obligations provided by AB 205 will encourage more couples to register as domestic partners. We base this prediction on the experience of Vermont's civil union legislation, which provides those entering into civil unions with all the rights and obligations of spouses in civil marriage. When compared to the number of same-sex couples identified by Census 2000, approximately 44% of Vermont's same-sex couples have entered into a civil union. Currently, the 19,905 couples registered as domestic partners under California law represent only 22% of the same-sex couples identified by Census 2000 as living in California. Thus, we assume that the comprehensive set of rights provided under Vermont law has caused a larger percentage of couples to seek legal recognition of their relationships. Likewise, AB 205 will probably provide a greater incentive for California couples to register as domestic partners than currently exists.

² AB 205 would not go into effect until January 1, 2005.

³ 17 CAL. LAW. REV. COM. REP., at 10.

⁴ Under California law, quasi-community property is liable to the same extent, and is treated the same in all other respects as community property. CAL. FAM. CODE ch. 2 §912 (1994).

⁵ "Debt" includes obligations incurred by contract, tort, or otherwise. CAL. FAM. CODE ch. 2 §902 (1994).

⁶ CAL. FAM. CODE ch. 2 §910 (1994) ; *In re Marriage of Brendle*, 54 CAL. RPTR. 397 (App. 2 Dist. 1996).

⁷ *Lezine v. Security Pacific Financial*, 58 CAL. RPRTR. 276 (1996).

⁸ CAL. FAM. CODE ch. 2 §913 (1994).

⁹ CAL. FAM. CODE ch. 2 §914 (1994). The married person is entitled to reimbursement if their separate property is applied to such a debt and nonexempt property in the community estate or separate property of the person's spouse is available but is not applied to the satisfaction of the debt.

¹⁰ 17 CAL. LAW. REV. COM. REP., at 10.

¹¹ FEDERAL RESERVE, *Debt by Outstanding Sector*, 2003 1ST QUARTER FLOW OF FUNDS ACCOUNTS OF THE UNITED STATES, Tbl. D.3 (June 5, 2003).

¹² The July 1, 2001, US population estimate by the U.S. Census Bureau is: 284,796,887. The per capita consumer debt (credit card plus mortgage debt) based on the numbers cited above would be \$28,125. While most statisticians do not include home mortgage debt when defining consumer debt, it is, nonetheless, a substantial and real burden borne by individual Americans.

¹³ This total estimate is conservative because it is based on the assumption that each household with a registered domestic partnership has only two people. In fact, many same-sex domestic partners in California have children and/or other relatives living in their households.

¹⁴ *Recent Changes in U.S. Family Finances; Evidence from the 1998 and 2001 Survey of Consumer Finances*, FEDERAL RESERVE BULLETIN, January 2003, at 29 tbl.14.

¹⁵ *Id.*

¹⁶ *U.S. Consumer Credit Quality Fall in 2Q* (Moody's Credit Market Trend Service), Aug. 21, 2003, at http://www.moodys.com/cust/displaySummar...&original=1&dpcument_id=150200000004975 (accessed on Aug. 22, 2003).

¹⁷ *Mortgage Delinquencies Decrease in MBA Survey for First Quarter of 2003*, Mortgage Bankers Association of America, June 20, 2003, available at <http://www.mbaa.org/news/2003/pr0620a.html> (accessed Aug. 22, 2003).

¹⁸ *Households Per Filing, Rank During the 12-Month Period Ending Dec. 31, 2002*, American Bankruptcy Institute, at <http://www.abiworld.org/stats/householdrank.html> (last visited ,Aug. 22, 2003).