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Fiduciary Duty: Lessons Learned

by Garrett C. Dailey, Esq.

Fiduciary duty will be the single most important issue for family law attorneys and forensic accountants in the coming years. We will no doubt learn many lessons as we continue to explore the parameters of this duty.

Redefining Marital Duties

The concept of spouses being fiduciaries is not new in California [*Fields v. Michael* (1949) 91 Cal.App.2d 443, 205 P.2d 402]. However, since the redefinition of marital duties in 1992, it has taken on a much more prominent role in marital dissolutions. *Marriage of Haines* [*In re Marriage of Haines* (1995) 33 Cal.App.4th 277, 297, 39 Cal.Rptr.2d 673] was one of the first important fiduciary cases of the modern era and held that a presumption of undue influence arises anytime one spouse obtains an advantage over another in a community property transaction. As applied in *Haines*, the presumption favored the community. Most family law attorneys did not pay much attention to the role of fiduciary duty in such situations—at least until *Marriage of Delaney* [*In re Marriage of Delaney* (2003) 111 Cal.App.4th 991, 999, 4 Cal.Rptr.3d 378] applied the *Haines* presumption to defeat a transfer that favored the community.

Although *Delaney* was not revolutionary, it was evolutionary and highlighted that the advantaged spouse must be able to show that the transaction was:

1. Freely and voluntarily made,
2. With full knowledge of all the facts, and
3. With a complete understanding of the effect of the transaction. If the spouse cannot, then the interspousal transaction could be set aside.

Does this mean that all transactions between spouses are void? Of course not. All, however, are vulnerable to the presumption of undue influence. But presumptions may be overcome when the evidence supports a finding that the transaction was freely entered into by the parties with a general understanding of its effect. In *Marriage of Friedman* [*In re Marriage of Friedman* (2002) 100 Cal.App.4th 65, 72, 122 Cal.Rptr.2d 412], for example, the wife's challenge to a postnuptial agreement as a breach of fiduciary duty was easily dispelled.

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Lessons Learned

Seven lessons learned from the fiduciary age are:

1. *All interspousal transactions may be scrutinized*—While all interspousal transactions may be scrutinized, they will not all be set aside simply because they were between unrepresented parties who failed to observe the myriad of legal niceties that competent lawyers would have interposed. Understanding that different judges will interpret and apply the fiduciary standards differently to interspousal transactions, most will examine the transaction to ensure both spouses were aware of the general effect of the transaction and that neither took unfair advantage over the other. In the common situation where the other spouse's name is added to a deed in a refinance, *Delaney* will be raised as a defense by the transferor in virtually every case. In most situations, if the trial judge believes that the transferor understood that by putting the other spouse's name on the deed the spouse was granting the other an ownership interest in the residence and did so willingly, it is doubtful that the transaction will be set aside simply because the spouse was unaware of the exact parameters of that decision.

2. *Disclose the details of assets and obligations during dissolution*—Failure to disclose the details of assets and obligations during dissolution will lead to undesirable consequences. *Marriage of Brewer and Federici* [*In re Marriage of Brewer and Federici* (2001) 93 Cal.App.4th 1334, 113 Cal.Rptr.2d 849] held that spouses have a duty to acquire and disclose relevant financial information that is available to them, even if no formal discovery requests are made, as outlined in Family Code Sec. 2100. The consequences of the failure to meet this duty can be the setting aside of the entire judgment.

3. *Legislative intent: adequate disclosure*—The legislative intent is that information regarding the community's finances be equally available to both spouses during marriage. Although Mr. Duffy dodged a bullet when he failed to adequately disclose the family's financial information to his wife during marriage [*In re Marriage of Duffy* (2001) 91 Cal.App.4th 923, 933-934, 111 Cal.Rptr.2d 160], SB 1936, Sec. 2, eff. Jan. 1, 2003, amended Family Code Sec. 721 to make it clear that it wanted full disclosure on request. What is not clear is what the remedies will be after separation for the failure to provide information upon request during marriage.

4. *Attention to legislation is necessary*—There are limits beyond which the Legislature is not presently prepared to go. After *Marriage of Duffy* held that spouses are generally not bound by the Prudent Investor Rule and do not owe the other the duty of care one business partner owes to another, attempts were made to amend Family Code Sec. 721 to include that duty. The Legislature

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rejected that request and made it clear that it was not imposing that duty on spouses (see "Prudent Investor Rule Does Not Apply to Investment Decisions Made During Marriage—Yet," *State Bar Family Law News*, Summer 2003, Vol. 25, No. 3, p. 5).

5. *Disclose intent to sell investments*—Spouses are not going to be held liable for the failure to know when to sell. A corollary to the previous lesson is that the values of investments go up and down. If the nonmanaging spouse wants to sell his or her share, whether before or after separation, then he or she must file a motion to do so [Family Code Sec. 2108 and Family Code Sec. 1101(b)]. A verbal request or letter demanding they be sold generally will be insufficient to trigger any sort of liability for the loss on the managing spouse [*In re Marriage of Reuling* (1994) 23 Cal.App.4th 1428, 1435, 28 Cal.Rptr.2d 726].

6. *Postseparation investment opportunities*—Postseparation investment opportunities are going to be scrutinized. Family Code Sec. 2102 (Sec. 2102) requires that any financial opportunities that result from marital activities be offered to the other spouse in writing in time to make an informed decision as to whether he or she desires to participate and for the court to resolve any resulting disputes on pain of having the gain from any such activity treated as if it were an undisclosed community asset.

A recent case limited the period of liability as ending upon the division of the asset from which the opportunity traced [*In re Marriage of Hixson* (2003) 111 Cal.App.4th 1116, 4 Cal.Rptr.3d 483]. Sec. 2102 is impractical and unwieldy in that few financial opportunities last long enough to permit a spouse to give sufficient notice before electing to participate. Strictly interpreted, the profits made by any spouse making such an investment could be ordered divided as an undivided community asset. Hopefully, the appellate courts will engraft a reasonableness limitation on the statute. However, even if this happens, this area must be examined.

7. *Investment opportunities during marriage*—Investment opportunities that occur during marriage also are going to be scrutinized. Advocates of strict fiduciary duty are pressing for a rule whereby the managing spouse will be strictly liable to the community unless he or she obtains written authorization for every investment, whether separate or community. Hopefully, a reasonableness standard will be applied here as well.

One prediction is safe—there will be an appellate opinion in the near future that will wrestle with this thorny issue. This area of law is going to develop quickly over the next few years. Sit back and enjoy what is certain to be an interesting ride.

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