Fiduciary Duty: Lessons We Will Learn

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Fiduciary duty will be the single most important issue for attorneys and forensic accountants in the coming years. There are many lessons to learn as we begin to explore the parameters of this duty in the marital context. The following is a brief discussion of those we have learned and others that are likely to be forthcoming.

The concept of spouses being fiduciaries is not new in California. In 1949, W. C. Fields' estate was subjected to claims by his spouse based upon his breach of his fiduciary duty to her even though they had been separated for decades.[1] Although the statutory duty was established as being one of "good faith," occasional cases did still speak in terms of spouses being fiduciaries to one another.[2] Over the years, a number of unsuccessful attempts were made to increase the marital duty to that of fiduciaries. In 1992, those pushing this change were finally successful and former Civil Code section 5125, subdivision (e), now Family Code section 1100, subdivision (e), was amended to read: "Each spouse shall act with respect to the other spouse in the management and control of the community assets and liabilities in accordance with the general rules governing fiduciary relationships which control the actions of persons having relationships of personal confidence as specified in [Family Code section 721], until such time as the assets and liabilities have been divided by the parties or by a court."

The law in this area developed slowly after the passage of the 1992 amendments to the code. In 1995, the first major case in this area was decided and held:

> [A] rebuttable presumption of undue influence arises when one spouse obtains an advantage over another in a community property transaction. ... The presumption that the advantage was gained by the exercise of undue influence continues until it is dispelled. [Citation.] The burden of dispelling the presumption rests on the spouse advantaged by the transaction.[3]

The case was *Haines* and the fact pattern was a common one, namely one spouse having received community property from the other during marriage, usually by way of a quitclaim deed. *Haines* did not say that such transfers were void, only that they were voidable unless the recipient spouse could overcome the presumption of undue influence that arose from interspousal transactions.

As applied in *Haines*, the presumption favored the community. Most family law attorneys did not pay much attention to the role of fiduciary duty when the transaction favored the community—at least until *Marriage of Delaney*.[4] For the first time, the Haines presumption was applied to defeat a transfer that favored the community as follows:

> The rationale of *Haines* clearly applies to *any* interspousal property transaction where evidence is offered that one spouse has been disadvantaged by the other.[5]

Although *Delaney* was not revolutionary, it certainly was evolutionary. This evolving body of law means we must now thoroughly investigate the manner in which community property is created. It also highlights the fact that transactions between spouses during marriage may be examined under the test set forth in *Haines* and *Delaney*, namely, can the advantaged spouse show: 1) that the transaction was 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 answer is "no," then the transaction potentially may be set aside.

Does this mean that all transactions between spouses are void? Of course not. It means that transactions are vulnerable to the presumption of undue influence. 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. For example, in *Marriage of Friedman*, the wife (who was an attorney) challenged a postmarital agreement on the grounds that it was procured by undue influence and the challenge was easily dispelled.[6]

Thus, the **first lesson** of the Fiduciary Age is that while all interspousal transactions may be scrutinized, they will not all be set aside merely because they were between unrepresented parties who failed to observe the myriad of legal niceties that competent lawyers would have required. Judicial offices will interpret and apply the fiduciary standards differently to interspousal transactions. Most courts will examine the transaction to ensure both spouses were aware of the general effect of the transaction and that neither took unfair advantage of the other.

In the common situation where the other spouse's name is added to a deed when the parties refinance their property, the *Delaney* case 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 s/he was granting the spouse an ownership interest in the residence and did so willingly, it is unlikely that the transaction will be set aside simply because the tranferee was unaware of the details of that decision.

The **second lesson** is that failure to disclose the details of assets and obligations during dissolution will lead to undesirable consequences. Jenness Brewer learned that the hard way.[7] Although she revealed the existence of her retirement plan and some information about her employment benefits with NBC in her Declaration of Disclosure, she did not voluntarily disclose all of what she had and what she had the ability to find out to Ovidio Federici, her self-represented artist husband. Although he had the ability to obtain the information he needed with a simple subpoena, the Court of Appeal held that since she was in a superior position to obtain records or information from which her employment benefits could be valued and could reasonably do so, she had a *sua sponte* obligation to acquire and disclose such information.[8] This is in direct contradiction to the way the dissolution game has been played. In the past, all that was required was to disclose the existence of the asset. It was then incumbent on the other spouse to do the requisite discovery and to form his or her own opinion as to value of the

asset.[9] Now, the obligation to disclose and to update disclosure exists even if no formal discovery requests are made.[10]

The **third lesson** is that the Legislature really intends 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,[11] the Legislature amended Family Code section 721 to make it clear that it wanted full disclosure on request.[12] What is not clear is what the remedies will be after separation for the failure to provide information upon request during marriage. Clearly the court will allow the set aside of judgments where there are undisclosed assets. The punishment for non-disclosure may look like what Judge Denner did in *Marriage of Rossi*—awarding the $1,000,000 lottery award to the uninformed husband.[13]

The **fourth lesson** is that 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 same duty of care that one business partner owes another, attempts were made to amend Family Code §721 to include that duty. The Legislature rejected that request and made it clear that it was not imposing that duty on spouses.[14]

The **fifth lesson,** a corollary to the previous lesson, is that the values of investments go up and they go down. Spouses are not going to be held liable for the failure to know when to sell them. If the non-managing spouse wants to sell his or her share, then he or she must file a motion to do so.[15] A verbal request or letter demanding they be sold will generally be insufficient to trigger any sort of liability for the loss on the managing spouse.[16]

The **sixth lesson** is that postseparation investment opportunities are going to be scrutinized. Family Code section 2102 requires that any financial opportunities that result from marital activities must be offered to the other spouse in writing in time to make an informed decision as to whether he or she desires to participate. It also requires 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.[17] This statute 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 pursuant to Family Code section 2556 as an undivided community asset. Hopefully, the appellate courts will include a reasonableness limitation on the statute.

The **seventh lesson** is that investment opportunities that occur during marriage are also going to be scrutinized. If one spouse has substantial separate property and is offered the opportunity to invest, must she first offer the opportunity to the community? If an unsuccessful investment is made with community property when there was separate property available, is the investing spouse liable to the community for the loss? Is the managing spouse acting in a realm of strict liability unless she obtains written authorization for every investment? Advocates of strict fiduciary duty say yes. We can only hope that the court will temper the application of this statute with a "reasonableness standard." One prediction is safe—there will be an appellate opinion in the near future that will wrestle with this thorny issue.

The **final lesson** is that 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. ■

Endnotes

1 *Fields v. Michael* (1949) 91 Cal.App.2d 443, 205 P.2d 402.

2 *See*, e.g., *In re Marriage of Munguia* (1983) 146 Cal.App.3d 853, 859, 195 Cal.Rptr. 199 ("Husband has exercised sole management and control over the property since [separation]. [former Civil Code section 5125 (e)] places a duty of good faith on the husband as a fiduciary for his wife which does not terminate upon separation of the parties as to assets remaining in his hands. [Citations.] It may be husband's fiduciary duty to maximize the value of the [business] by securing a continuation of the lease.").

3 *In re Marriage of Haines* (1995) 33 Cal.App.4th 277, 297, 39 Cal.Rptr.2d 673.

4 *In re Marriage of Delaney* (2003) 111 Cal.App.4th 991, 999, 4 Cal.Rptr.3d 378.

5 *Id.* at p. 999 (emphasis in the original).

6 *In re Marriage of Friedman* (2002) 100 Cal.App.4th 65, 72, 122 Cal.Rptr.2d 412.

7 *In re Marriage of Brewer and Federici* (2001) 93 Cal.App.4th 1334, 113 Cal.Rptr.2d 849.

8 *Id.* at p. 1348.

9 *In re Marriage of Connolly* (1979) 23 Cal.3d 590, 153 Cal.Rptr. 423, 591 P.2d 911.

10 *See*, e.g., Fam. Code, § 2100.

11 *In re Marriage of Duffy* (2001) 91 Cal.App.4th 923, 933-934, 111 Cal.Rptr.2d 160.

12 An uncodified section of Family Code section 721 reads as follows: "It is the intent of the Legislature in enacting this act to clarify that Section 721 of the Family Code provides that the fiduciary relationship between spouses includes all of the same rights and duties in the management of community property as the rights and duties of unmarried business partners managing partnership property, as provided in Sections 16403, 16404, and 16503 of the Corporations Code, and to abrogate the ruling in *In re Marriage of Duffy* (2001) 91 Cal.App.4th 923, to the extent that it is in conflict with this clarification."

13 *Marriage of Rossi* (2001) 90 Cal.App.4th 34, 108 Cal.Rptr.2d 270.

14 *See*, Dailey, *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.

15 Fam. Code, §§2108, §1101, subd. (b).

16 *See*, *In re Marriage of Reuling* (1994) 23 Cal.App.4th 1428, 1435, 28 Cal.Rptr.2d 726.

17 *In re Marriage of Hixson* (2003) 111 Cal.App.4th 1116, 4 Cal.Rptr.3d 483.