ACFLS
FAMILY LAW SPECIALIST
WWW.ACFLS.ORG
SPRING 2015, NO. 2
JOURNAL OF THE CALIFORNIA ASSOCIATION OF CERTIFIED FAMILY LAW SPECIALISTS

NON-COMPETE ORDERS AND AGREEMENTS IN A FAMILY LAW ACTION

CHRISTOPHER C. MELCHER, CFLS | LOS ANGELES COUNTY | CCM@WALZERMELCHER.COM

I. Introduction

Business interests are routinely divided in family law actions, but we rarely see non-compete orders or agreements against the bought-out spouse. A non-compete order or agreement protects the value of a business awarded to one spouse, by prohibiting the other spouse from engaging in a similar business.

The court has the legal authority to prohibit a spouse from engaging in any business that competes with the business awarded to the other spouse in a divorce. Parties may also make a non-compete agreement in connection with a divorce settlement. There is a strong public policy favoring a person's right to pursue any lawful business, trade, or occupation, so a non-compete order or agreement will be deemed void unless the provision is reasonably necessary to protect the value that person receives for his or her interest in the community business. To be valid, the business must have goodwill, and the terms of the non-compete agreement or order must be narrowly tailored.

This article discusses the circumstances in which a family law court may make a non-compete order, the authority of the parties to make a non-compete agreement, and the proper scope of such an order or agreement. Trade secrets will also be addressed.

II. Non-Compete Agreements

A. Agreements Restraining Lawful Work are Generally Void

Any agreement that restrains an individual from engaging in a lawful profession, trade, or business of any kind is void, except as otherwise provided. CAL. BUS. & PROF. CODE §§ 16600-16602.5, 20. "California courts have consistently declared [section 16600] an expression of public policy to ensure that every citizen shall retain the right to pursue any lawful employment and enterprise of their choice." *Metro Traffic Control, Inc. v. Shadow Traffic Network,* 22 Cal. App. 4th 853, 859 (1994).To be void, the agreement does not have to totally preclude a party from engaging in a profession, trade, or business; any restriction is invalid unless one

WHAT'S INSIDE

ACFLS
FAMILY LAW SPECIALIST
SPRING 2015, NO. 2
JOURNAL OF THE CALIFORNIA ASSOCIATION OF CERTIFIED FAMILY LAW SPECIALISTS

PRESIDENT
Jill L. Barr, CFLS

VICE-PRESIDENT
Seth D. Kramer, CFLS

JOURNAL EDITOR
Debra S. Frank, CFLS

ASSOCIATE JOURNAL EDITOR
Christine Diane Gille, CFLS

PRINTING
Print2Assist

PRODUCTION COORDINATOR
Sublime Designs Media

Family Law Specialist is a publication of the Association of Certified Family Law Specialists.

Send your submissions in Word or WordPerfect by email to:
Debra S. Frank, cfls
Journal Editor
Email: dfrank@debrafranklaw.com

ACFLS MISSION STATEMENT

It is the mission of ACFLS to promote and preserve the Family Law Specialty. To that end, the Association will seek to:

1. Advance the knowledge of Family Law Specialists;
2. Monitor legislation and proposals affecting the field of family law;
3. Promote and encourage ethical practice among members of the bar and their clients; and
4. Promote the specialty to the public and the family law bar.

ACFLS EXECUTIVE DIRECTOR

For circulation, membership, administrative and event registration requests, contact:

Dee Rolewicz, ACFLS Executive Director
1500 W. El Camino Avenue, Suite 158
Sacramento, CA 95833-1945
(916) 217-4076 • Fax: (916) 930-6122
Email: executive.director@acfls.org

of the statutory exceptions applies. *Edwards v. Arthur Andersen LLP*, 44 Cal. 4th 937, 946-947 (2008).

B. Exception for Agreements re Sale or Disposition of Business

Noncompetition clauses are expressly permitted in connection with the sale or disposition of a partnership, limited liability company (LLC), or corporation (CAL. BUS. & PROF. CODE § 16601), the dissolution of a partnership or disassociation of a partner from the partnership (§ 16602), or the dissolution of a LLC or the termination of an interest in a LLC (§ 16602.5). If one of these exceptions applies, then the owner of the business interest "may agree with the buyer to refrain from carrying on a similar business within a specified geographic area in which the business so sold … has been carried on, so long as the buyer, or any person deriving title to the goodwill or ownership interest from the buyer, carries on a like business therein." § 16601.

An agreement by one spouse to transfer an interest in a business entity to the other spouse in connection with a divorce should qualify under the exceptions to section 16600. For example, section 16601 permits any person "who sells the goodwill of a business, or any owner of a business entity selling *or otherwise disposing of* all of his or her ownership interest in the business entity" to enter into a non-compete agreement. § 16601 (emphasis added). A transfer of a business interest from one spouse to another pursuant to an agreement is a "disposition" of that party's interest within the meaning of section 16601. Also, treating divorce agreements the same as regular business agreements in this context is consistent with the statutory purpose of section 16601. "The reason for this exception to the general rule against noncompetition covenants is to prevent the seller from depriving the buyer of the full value of its acquisition, including the sold company's goodwill." *Alliant Ins. Services, Inc. v. Gaddy*, 159 Cal. App. 4th 1292, 1300 (2008).

Therefore, parties to a divorce may enter into a non-compete agreement, and that agreement will be enforced, provided that the agreement meets the other requirements of sections 16601 to 16602.5. Those requirements are discussed below.

C. Requirements for Valid Non-Compete Agreements

A non-compete agreement made in connection with the sale, disposition, or dissolution of an ownership interest in a business entity must satisfy the following requirements to be valid:

1. Restricted to Similar Business

The agreement may only restrict the seller from carrying on a "similar business" to the one sold. § 16601. The California Legislature did not intend to permit "restraints upon all business transactions of whatever character, regardless of their noncompetitive effect, their insubstantial nature, or their infrequent occurrence. Instead, [the California Supreme Court has] concluded that in using the words 'carry on a similar business,' the Legislature had in mind the direct or indirect transaction or solicitation of substantial business activities in competition with the covenantee, rather than the occurrence of isolated, occasional transactions not substantially affecting the covenantee's competition position." *Swenson v. File*, 3 Cal. 3d 389, 397 (1970) (citation omitted). The Court in *Swenson* added: "Ordinarily, a single, isolated transaction does not constitute 'carrying on business' under statutes using that or similar terminology." *Id.* at p. 397, fn.5 (citation omitted).

2. Specified Geographic Area

The agreement must be limited to "a specified geographic area in which the business so sold … has been carried on." *Id.* at p. 397. "The geographic scope of a noncompetition

covenant must be limited to the area where the sold company carried on business because '[o]therwise, a seller could be barred from engaging in its business in places where it poses little threat of undercutting the company it sold to the buyer.'" *Alliant,* 159 Cal. App. 4th at 1301 (citation omitted). "[T]he area where a business is 'carried on' [within the meaning of section 16601] is not limited to the locations of its buildings, plants and warehouses, nor the area in which it actually made sales. The territorial limits are coextensive with the entire area in which the parties conducted all phases of their business including production, promotional and marketing activities as well as sales." *Monogram Indus., Inc. v. Sar Indus., Inc.*, 64 Cal. App. 3d 692, 702 (1976).

3. Duration Limited to While Buyer is Carrying on Similar Business

The agreement may only last as "long as the buyer, or any person deriving title to the goodwill or ownership interest from the buyer, carries on a like business [within the specified geographic area]." CAL. BUS. & PROF. CODE § 16601.

4. Business Must Have Goodwill Which Was Sold

The business must have goodwill at the time of the sale, disposition, or termination of the business interest, and "there must be a clear indication that in the sales transaction, the parties valued or considered goodwill as a component of the sales price." *Hill Medical Corp. v. Wycoff*, 86 Cal. App. 4th 895, 900 (2001). The value protected by a non-compete agreement is the goodwill of the business. "In order to restrain the seller's profession, trade, or business, there must be a clear indication that in the sales transaction, the parties valued or considered goodwill as a component of the sales price, and thus the ... purchasers were entitled to protect themselves from 'competition from the seller which competition would have the effect of reducing the value of the property right that was acquired.'" *Id.* at 903.

III. Non-Compete Orders

The next question is whether a family law court may enter a non-compete order against a party, over that party's objection, when the court awards a business interest to one party in a marital dissolution. The answer is yes, it can. *See Marriage of Greaux & Mermin*, 223 Cal. App. 4th 1242 (2014).

In *Greaux & Mermin,* the court awarded a community business to the husband and ordered the wife not to compete with that business. *See id.* The Court of Appeal in *Greaux & Mermin* held that the trial court had the legal authority to make the non-compete order, but reversed and remanded the case because the length and geographic scope of the non-compete order were overly broad. *Id.* The Court of Appeal held that Business and Professions Code section 16600 does not prohibit the issuance of a non-compete order. *Id.* The court stated:

> Family law courts have broad statutory powers to make any orders the court considers necessary to achieve a fair and equal division of the community property, including a do-not-compete order. If section 16600 were interpreted to prohibit such family law orders, the proscription would unduly restrict the court's inherent equitable powers and inhibit its ability to achieve a fair division of property. The order entered here was a 'logical way to preserve the integrity of [the court's] award of SBSC to [husband] and the value of the business,' and was supported by ample evidence….
>
> Countervailing the public policy in favor of free competition is the state's '"paramount interest"' in the fair and equal distribution of marital property upon the dissolution of a marriage. (*In re Marriage of Potter* (1986) 179 Cal.App.3d 73, 81 [224 Cal. Rptr. 312].) Family courts have therefore been granted broad statutory powers to accomplish a just and equal division of marital property (Fam. Code, §§ 2550, 2553) and possess "broad discretion to determine the manner in which community property is awarded in order to accomplish an equal allocation. [Citation.]" (*In re Marriage of Andresen* (1994) 28 Cal.App.4th 873, 880.) "This task constitutes a nondelegable judicial function [citation] which must be based upon substantial evidence [citation]." (*Ibid.*) Pursuant to statute, the court may make "any orders the court considers necessary" to achieve the statutory mandate. (Fam. Code, § 2553.) …
>
> It therefore follows that, if an ongoing marital business is being awarded to one spouse, and if the value of that business includes goodwill, a family court should have the power, pursuant to Family Code section 2553, to issue a noncompetition order so that the value of that asset is preserved, just as a noncompetition clause in a business purchase and sale agreement is designed to protect the value of the asset purchased.

Greaux & Mermin, 223 Cal. App. 4th at 1249-1250.

Even though a non-compete order is not precluded by section 16600, a court must still comply with the same requirements that apply to non-compete agreements when issuing a non-compete order.

A. Scope of Order in Greaux & Mermin

The trial court in *Greaux & Mermin* ordered that "[Wife] shall refrain from further conduct intended or likely to damage either business in any way and shall be subject to a five-year non-competition order." *Id.* at 1247. It appears that the trial court also made the following orders at the husband's request:

> [Wife is] restrained and enjoined from:
>
> (1) contacting or communicating with 'any person or entity in the SBSC/Batiste infrastructure'

including its growers, distillers, shippers, bottlers, distributors, attorneys, employees, consultants, customers 'or other persons doing business with SBSC';

(2) holding herself out as a representative of SBSC or of the brand Batiste;

(3) holding herself out as having any connection or involvement with SBSC or Batiste rum; and

(4) entering the premises of SBSC or dealing with the books, bank accounts and records of SBSC….

[Also, wife is] 'restrained and enjoined from competing with [husband] or SBSC for a period [of] five years from entry of judgment herein. She shall not ... [set] up a company of her own or with other investors, or persons or entities engaged in the production, bottling, marketing or selling [of] *Rhum Agricole* or rum of any kind, wherever produced or grown. Further, [Wife] shall not consult with any person or entity that is in competition with or could be in competition with SBSC's rum product or who proposes to offer a competing product. She shall not work for a competitive *Rhum Agricole* product or other rum product during the five year period.'

Id. at 1247-1248.

The Court of Appeal in *Greaux & Mermin* held that the "the scope of prohibited activities and the length of the prohibition [must] be based on findings supported by substantial evidence that they are reasonably necessary to protect the value of the asset awarded in the dissolution." *Id.* at 1255. "Here, wife was restrained from working in a *rhum agricole* business or other rum product business, or any other business that 'could be in competition with SBSC's rum product' for a period of five years, without geographical limitation." *Id.* This was an abuse of discretion because the "statement of decision, however, contains nothing about the geographic market of SBSC at the time of the dissolution, nor does it contain any findings to support the unlimited geographic reach of the order." *Id.*

B. Problem with Arguing that there is No Goodwill

Another issue with the non-compete order in *Greaux & Mermin* was the potential lack of goodwill of the community business. The Court of Appeal observed:

> According to the trial court's statement of decision, there was undisputed evidence that SBSC had no value attributable to goodwill, but did have an 'in-place value' (based on existing contracts) of $49,000. Because the issue is not before us, we express no opinion as to whether a noncompetition order can be imposed in the absence of goodwill if there is some other evidence demonstrating a need to protect the value of the asset assigned to one of the parties by the issuance of a noncompetition order. It is clear, however, that a court must be able to point to evidence that supports the necessity of the order to protect the value of the business 'as a going concern.'

Id. at 1255-1256 (citations omitted).

So, care needs to be taken when arguing that a business has no goodwill if the client wants that business awarded to him or her, with a non-compete order against the other party. If the court agrees that the business has no goodwill, then there is no legal authority to make a non-compete order.

C. Evidence of Interference

The law does not require evidence of interference with the business, or a showing that a party intends to compete, as a prerequisite to making a non-compete order. Still, it helps. In *Greaux & Mermin*, the trial court found:

> The parties … had personal conflicts that took their 'inevitable toll on the business itself ... [e]ven during the company's earliest, most formative days.' … [W]ife filed concurrent actions against SAF and SBSC, and lawsuits against key SBSC resource contacts. Wife also disrupted the business operations of SBSC by withdrawing operating capital on two occasions and making statements to employees 'portending the demise of the businesses.'
>
> In the lawsuits, wife sought to dissolve SAF and SBSC, assailed the personal integrity of individuals associated with SBSC, and 'substantially compromise[ed] the company's ability to attract essential capital.' She alleged that SBSC was `insolvent or in imminent danger of becoming insolvent,' and accused product suppliers, corporate officers and corporate counsel of fraud and conspiracy. 'Although she ultimately dismissed all of those actions, considerable harm had already been done.'…
>
> Further, husband had 'demonstrated the will and ability to [run the business] under extremely adverse circumstances,' while wife had shown 'a willingness to sacrifice the interests of SBSC for what appeared to have been little more than spiteful retribution.'

Id. at 1246-1247.

D. Injunction

The *Greaux & Mermin* decision does not discuss whether the requirements for a preliminary injunction must be satisfied when a court makes a non-compete order. It appears that those requirements must be followed, since a non-compete order is a form of an injunction. *See* CAL. CIV. PROC. CODE § 525.

E. Compare Trade Secrets

"The right of free competition is also constrained by California's Uniform Trade Secrets Act, which prohibits the use of another's trade secrets to compete even where the parties have entered into an invalid noncompete agreement

under section 16600." *Greaux & Mermin,* 223 Cal. App. 4th at 1249, fn.3 (citing CAL. CIV. CODE § 3426 et seq.; *Morlife, Inc. v. Perry,* 56 Cal. App. 4th 1514, 1520 (1997); *Scott v. Snelling and Snelling, Inc.* 732 F. Supp. 1034, 1042 (N.D. Cal. 1990)).

The Court of Appeal in *Greaux & Mermin* stated that "the value of a marital asset's trade secrets may also be an appropriate matter for the family court to consider." *Id.* at 1252. Trade secrets, such as customer lists, may be protected by court order even without a non-compete order.

IV. Conclusion

The parties may enter into an agreement prohibiting the other party from competing with a community business that is awarded to one party, provided that the scope of the order is reasonable and the business has goodwill. When the parties cannot agree, the court may make such an order over the objection of the other party. These orders and agreements should be considered whenever the client is concerned that the bought-out spouse will compete with the community business after division. ■

Christopher C. Melcher specializes in complex family law litigation and premarital agreements. He also handles family law appeals. He is a former Chair of The State Bar of California Family Law Section.

ACFLS MEMBERSHIP APPLICATION

Eligibility for ACFLS membership is limited to attorneys certified as family law specialists by the State Bar of California, Board of Legal Specialization.*

Applicant name _____ State bar no. _____ Date certified as CFLS by BLS _____

Firm name _____

Address _____ City/State/Zip _____

Telephone _____ Fax _____

Email _____ Website _____

If more than one member of the firm is joining, please attach additional page with information about each applicant.

Dues for first member in firm: $250 Dues for ____ additional members from same firm: $175 each. Total amount of payment $_____

*Retired member who is no longer practicing, or judicial officer who was a member at the time he/she went on the bench: $150

❑ Check enclosed Charge to ❑ Mastercard ❑ Visa Credit card account no. _____ Expiration date_____

Name as it appears on credit card _____ Authorized signature _____

Credit card billing address ❑ Same as above ❑ Different billing address _____

Join online at www.acfls.org or send your application and payment by mail to: Dee Rolewicz, ACFLS Executive Director, 1500 W. El Camino Avenue, Suite 158, Sacramento, CA 95833-1945 or fax: (916) 930-6122 or scan and email to Executive.Director@acfls.org

President's Message

Jill L. Barr, CFLS | ACFLS President | Sacramento County
jill@hemmerbarrlaw.com

The 23rd Annual Spring Seminar concluded with great success this year. Thank you to all the presenters, the Judicial Responder Panel, and Garrett Dailey for providing an outstanding program. I would also like to express my gratitude to the Spring Seminar Committee (under the leadership of Patricia Rigdon, Co-Chair) and the entire ACFLS Board who all combined their efforts to deliver another excellent seminar. Dee Rolewicz, Executive Director, and Rachelle Santiago, Administrative Assistant, also provided invaluable assistance to all.

We start planning these annual seminars about ten to eleven months in advance and have booked dates with the hotel (Omni Rancho Las Palmas in Rancho Mirage) for the next two years. I urge you to consider attending next year if you have not done so in the past, as the combination of the high caliber program content/presenters with the venue truly allows for a worthwhile experience. In addition, you have the added bonus of networking with other family law attorneys and professionals from around the state. If you are lucky, you might catch Ron Granberg playing the harmonica with the hotel band!

Although we spend much of our time and energy as a Board on the Spring Seminar, we do have other business that keeps us busy, including (but certainly not limited to) continuing to provide excellent educational opportunities and information through our local chapters and this terrific periodical. We also have a huge catalog of DVDs available for purchase of past presentations. Please peruse our catalog and/or website for more information.

Also, in the next few months, our awards committee, led by Sherry Peterson, Education Director, will be soliciting nominations for our Hall of Fame and Outstanding Service to Family Law awards. Please look for these announcements/solicitations and let Sherry know if you have a nominee.

Our Nominating Committee, chaired by Vice President Seth Kramer, will be considering nominations for board openings in the near future. If you are interested in serving on the board or know of someone who is interested, please provide the information to Seth for consideration by the Nominating Committee.

We also have several other very active committees, such as the Legislative Advisory Committee, which monitors all California Family Law legislation. This is the committee that drafted and prompted the anti-*Bobblitt* legislation that ACFLS sponsored last year. This committee also actively reviews all proposed legislation that impacts the practice of family law. ACFLS periodically comments or takes positions on proposed legislation.

The Amicus Committee is co-chaired by Leslie Shear and Stephen Temko, who are both dual certified as Specialists in Family and Appellate Law. This Committee reviews requests for amicus briefs and considers seeking publication of cases that may impact the practice of family law. As of this writing, ACFLS has successfully sought publication of *Winternitz v. Winternitz,* 235 Cal. App. 4th 644 (2015).

These are just a few examples of some of the actions/activities in which we engage as a Board. There is, of course, much more that we are doing, all with the goal of improving what we do as an organization. We are constantly striving to achieve our mission: We endeavor to advance the knowledge of Family Law Specialists; monitor legislation and proposals affecting the field of family law; promote and encourage ethical practice among members of the bar and their clients; and promote the specialty to the public and the family law bar. ■

From the Editor's Desk

Debra S. Frank, CFLS | ACFLS Journal Editor | Los Angeles County

dfrank@debrafranklaw.com

In the next few issues we will be modifying the format of the *ACFLS Family Law Specialist*. We welcome our new production coordinator Sublime Designs Media LLC.

The ACFLS Family Law Specialist is one of many of ACFLS's efforts to promote the education of its members. In her President's Message, Jill Barr reviews many of the activities and actions of ACFLS, including the recent, ever successful Spring Seminar.

In light of the decision in *In re Marriage of Greaux and Mermin*, our lead article by Chris Melcher, "Non-Compete Orders and Agreements in a Family Law Action," provides guidance as to the requirements for enforceable non-compete orders or agreements.

This issue includes two articles on premarital agreements. Geniveve Ruskus, in "A Better Prenuptial agreement: Premarital Agreements Reimaged as Partnership Agreements," discusses the process of crafting premarital agreements. She reminds the reader that the process should benefit both parties in a marriage, allowing "couples to have a meaningful discussion with their partners about their goals and interests and how best to achieve them. It empowers them to customize the rules regarding their finances during the intact marriage as well as upon death or divorce."

In his article discussing various approaches to provide for limited spousal support in prenuptial agreements, Peter Walzer reminds us that even though limits have been allowed in California for fifteen years, "parties cannot be sure whether their limitation clauses will be enforceable at the time of divorce" as the trial court is required to determine whether enforcing the limitation would be "unconscionable at the time of enforcement."

Robert Marmor's article, "Attorneys as Escrow Holders or, 'No Problem. We'll Just Deposit the Sale Proceeds into my Trust Account,'" alerts the reader to some of the potential pitfalls that await the attorney escrow holder, suggests ways to minimize risk to the attorney, and offers some practical options to the attorney asked to serve as escrow holder.

In "Tax Relief for Injured and Innocent Spouses," Kneave Riggall, Certified Tax Law Specialist, describes fifteen ways that California and federal tax law can reduce, or even eliminate, taxes and costs for injured and innocent spouses.

Dawn Gray's article, "Hot Off the Press," includes the holdings of most recent significant cases, as well as the summaries of other recent cases, and directs you to the ACFLS website's members-only area to view her entire article with the complete case summaries.

Many of you recently attended our highly successful 23rd Annual ACFLS Spring Seminar, "Submitted: Mastering Rulings, Orders & Judgments," and heard outstanding presentations and speakers. The Spring Seminar committee is already hard at work to bring you another outstanding seminar. Save the date! April 1-3, 2016 at Omni Rancho Las Palmas Resort and Spa in Rancho Mirage.

Your Editorial Board has many great ideas for future editions of the *ACFLS Family Law Specialist*. If you are interested in working with us or would like to submit an article, please contact me or anyone on the Editorial Board: Christine Gille (Los Angeles County), John D. Hodson (Solano County), Richard Gould-Saltman (Los Angeles County), and Jason Schwartz (Orange County). Many thanks to the Editorial Board for all their time, effort, and significant contributions to the preparation and completion of the ACFLS Family Law Specialist. ■

A Better Prenuptial agreement: Premarital Agreements Reimaged as Partnership Agreements

Geniveve Joan Ruskus, CFLS* | Santa Clara and San Mateo Counties | gruskus@lakinspears.com

Geniveve J. Ruskus has practiced in the field of family law since her admission to the California Bar in 1996. Although her background is in family law litigation, Geniveve's practice emphasizes mediation and other alternate dispute resolution techniques in order to minimize costs (emotional and financial) for her clients. In addition to her divorce practice, she handles premarital, cohabitation and postmarital agreements as well as post-dissolution and paternity matters.

Introduction: Premarital Agreements are Here to Stay—Why not Make Them Better?

Nationwide, premarital agreements are on the rise.[1] A 2015 survey of the Northern California Chapter of the American Academy of Matrimonial Lawyers reveals that California is no exception to this trend.[2] A surprisingly robust number of practitioners surveyed— 77%—routinely include premarital agreements as a part of their practice.[3] Among practitioners who included premarital agreements as part of their practice over the past ten years, a majority are now doing *more* than ever before.[4]

Referring to this data as "surprising" reveals my own preconceptions prior to conducting the survey. Although currently I am drafting, reviewing, and mediating more premarital agreements than in years past, I expected to find few responders drafting these agreements, with a declining as opposed to rising trend. This is clearly not the case. I believe my mistaken expectation is a result of the fact that the voices opposing premarital agreements, among both our colleagues and the general public, are often louder and more insistent than the supporters'.

Survey respondents who do *not* include premarital agreements as part of their practice recited a list of concerns, chief among them a distaste for the concept of premarital agreements (some referred to them as "nothing more than divorce planning instruments"), and a fear of being sued years later for damages that could eclipse the fees collected for the original premarital agreement.

Premarital agreements don't just have a bad reputation among lawyers. There continues to be a stigma in the media associated with such agreements. In the 2014 movie *Gone Girl*, for example, a bitter husband stores his copy of a premarital agreement in a "box of hate," nestled among letters he found between his wife and her ex-boyfriend and the expiration notice for his fertility materials.

I argue here that, since premarital agreements are here to stay, they can actually be *good* or, at the very least, better if we re-examine the way that they are crafted, not only substantively but also procedurally. The better premarital agreement educates couples about the legal rules on the front end, and informs them, through the disclosure process, about their respective finances. The better premarital agreement enables couples to have a meaningful discussion with their partners about their goals and interests and how best to achieve them. It empowers them to customize the rules regarding their finances during the intact marriage as well as upon death or divorce. The better premarital agreement, by no means a panacea to divorce, sets the stage for successful conflict resolution and compromise.

Marriage as a Going Concern: The Operating Agreement Model Applied to Premarital Agreements

Getting married is one of the most profound financial decisions a person can make. The acts of joining assets and income and taking on joint liability for another's actions can have significant impact. While premarital agreements may be on the rise, the vast majority of married couples, over 90% according to one authority, still get married without one. [5] As such, they get married without having an explicit mutual understanding about their financial situation, goals, and expectations. Instead, they confidently (and all-too-often naively) rely upon the "trustworthiness" of their spouse and

their belief that future problems will be handled "fairly." We have all seen the devastation that can occur when parties wait until the end of their marriage to talk about what financial arrangement each thinks is fair.

The better premarital agreement does not focus solely on the protection of a single spouse's financial interests as imagined from the rearview mirror of divorce planning. The better premarital agreement looks instead like a joint plan, based on the mutual goals and interests of prospective financial partners; an operating agreement that is the product of mutual goal setting and financial planning to achieve those goals.

According to the United States Small Business Association (SBA), parties entering into any business relationship are well advised to form an operating agreement for three reasons: 1) to protect their personal liability, 2) to clarify verbal agreements, and 3) to ensure that the agreements between the parties are legally enforceable in the event that the business dissolves. As the SBA website explains, "[s]tate default rules govern LLCs without an official operating agreement. This means that each state outlines default rules that apply to businesses that do not sign operating agreements. Because the state default rules are so general, it is not a good idea to rely on them for your agreement."[6]

The rationale for having a business operating agreement applies with equal force in the marriage context. When advising a client about whether or not he or she "needs" a premarital agreement, I often point out that the California Family Code ("FC") imposes a "premarital agreement" on you whether you know about it or not. The important thing is to understand the default rules and how they would apply to you, test them against your own values, goals, and interests and, if they fail to match, pursue a premarital agreement so that the rules governing marriage reflect the couple's mutual desires rather than the presumptions of the legislature.

Returning to the SBA's model, there are three over-arching topics that the SBA recommends be addressed in any operating agreement. [7] First, to determine **who owns what,** an operating agreement should address the percentage of membership ownership and distribution of profits and losses. Next, the operating agreement should govern **how the business is to be operated,** including voting rights and responsibilities, powers and duties of members and managers, and holding meetings to discuss and resolve issues as they arise. Finally, an operating agreement should address "**Buy-Out" and "Buy-Sell Provisions**," including provisions for voluntary dissolution of the business and procedures for transferring a member's interest if there is a death during the term of the business.

The vast majority of premarital agreements today, unlike the SBA model, devote the bulk of their pages to what happens upon divorce——the "voluntary" dissolution of the partnership——including a great many boilerplate provisions aimed at strengthening the enforceability of the agreement in anticipation of a challenge in a court setting. At most, they include just a paragraph or two on how the business of the marriage is to be conducted while the parties are happily married, and what would happen if the marriage ends upon death. The better premarital agreement gives equal if not greater focus to operating topics as well.

Who Owns What?

In a business operating agreement, the prospective business partners must determine who is to contribute what to the business, both in terms of labor and capital, and how to split the income and liabilities of the business over time.

While most California premarital agreements do a fairly good job identifying the character of assets going into the marriage, as well as the character of the income to be earned during marriage and debts that may be incurred, in my experience this is usually an all-or-nothing proposition. Many times the separate property brought into marriage is identified and permitted to grow unshackled by the specter of apportionment pursuant to the *Pereira/Van Camp/Beam* line of cases, while the income and debts accrued during the marriage are either also kept wholly separate or are shared fifty-fifty. Only very rarely have I seen people attempt to enter into an agreement that customizes the percentages *between* the two extremes of zero and fifty-fifty.

This "all or nothing" approach to marital property and income is actually a minority[8] view, although I would hazard a guess that few of us present it this way to our clients. The majority of states have elected the equitable distribution statutory scheme, in which much more discretion is awarded to the courts and the parties to divide their marital property, at least in the divorce context. "Most states follow equitable distribution laws. In these states, property acquired during the marriage belongs to the spouse who earned it. In case of divorce, the property will be divided between the spouses in a fair and equitable manner. There is no set rule determining who receives what or how much; the court considers a variety of factors. For example, the court may look at the relative earning contributions of the spouses, the value of one spouse staying at home or raising the children, and the earning potential of each. *A spouse can receive between one-third and two-thirds of the marital property.*"[9] In a mobile society in which there is always at least a chance that the couple will move out of California at some point during the marriage, it is imperative that family law advisors not only advise clients of the California rules, but also let them know that they have choices.

In a business partnership agreement, it would not be uncommon for one partner to be assigned, for example, 75% of the income, and the other 25%, in recognition not only of differing assets and skills that each contributes to the partnership, but also the different roles that will be performed in the ongoing business by each partner. Likewise, in a prenuptial agreement, it is possible to allocate assets, income, and liabilities in creative ways, such as:

- An ownership percentage between zero or fifty-fifty, perhaps depending on factors such as premarital wealth, the expectation of inheritance, earning capacity, or the likelihood that time will be spent out of the workplace for raising children.
- Different ownership percentages for different categories of assets. For example, wage and salary income might be

fifty-fifty, while other categories (perhaps new businesses or intellectual property assets) would be 60% the separate property of the operating spouse or the inventor, and 40% belonging to the other spouse.

- A vesting schedule in which assets either begin as the separate property of each spouse, and "vest" over time so that ultimately they become entirely community property, or alternatively, are transmuted upon marriage to community property but remain subject to a FC section 2640 right of reimbursement that diminishes ratably over time on divorce. This type of structure would also enable the spouses to take advantage of the special tax treatment of community property on death.[10]

In sum, family law practitioners should dare to engage in a deeper discussion with their clients about how assets, debts, and income are to be owned, rather than confining the discussion to the all-or-nothing approach of what is to be "separate," and what is to be fully fifty-fifty.

How is the Business to Be Operated?

In a business operating agreement, it is standard to include provisions about the voting powers and managerial responsibilities of each of the prospective partners. In the marriage context, provisions about the operation of the business can be broken down into two sets of issues——the first being the practical, logistical issues of managing the couple's financial affairs, and the second dealing with the ability of spouses to alter their fiduciary relationship with one another during the ongoing marriage in terms of management and control.

Although today's premarital agreements discuss the allocation of income and liabilities during the marriage, this is almost always addressed from the rear-view perspective of divorce. Income will be identified as community property, but there are often few words in the agreement about where that income will reside, who will have the ability to withdraw/invest, etc. As for liabilities, again there may be a few provisions reiterating community debt presumptions, but premarital agreements usually do not contain topics such as the ability of one spouse to undertake financially risky business endeavors or engage in debt financing. Most, if not all, couples would benefit from a discussion with a financial advisor so they can begin to understand one another's risk tolerance, and at least anticipate making a financial plan. This discussion could include other logistical details regarding how certain expenses are to be paid, plans for saving for retirement, and the needs of children and elderly parents, for example, and these terms then become an important part of the better prenuptial agreement.

In discussing the ongoing management of the partnership of marriage, another important set of issues concerns the fiduciary duties owed between spouses. California has a long tradition of fiduciary duties that bind spouses, as codified in FC section 720 *et seq.* FC section 721(b), which states that "this confidential relationship is a fiduciary relationship subject to the same rights and duties of non-marital business partners, as provided in sections 16403, 16404 and 16503 of the Corporations Code…" These duties include providing each spouse with a right of access to books and records, providing information upon request concerning community property transactions, and accounting to the other spouse and holding as a trustee any benefits that concern community property.

These fiduciary duties, not all of which are totally intuitive to a layperson, should be reviewed in detail with couples so they have this information from the very beginning and can tailor these duties to their own needs and interests, to the extent permissible by law.

Certain fiduciary duties are probably not waivable as a matter of public policy. These would include, for example, eliminating the obligation of good faith and fair dealing and/or the duty of loyalty, and unreasonably restricting the right of access to information and records, as well as the duty of care.[11] However, this does not mean the topic of management and control is utterly taboo. FC section 1612(a)(5) provides that a premarital agreement may address "personal rights and obligations, not in violation of public policy or a statute imposing a criminal penalty." Dawn Gray and Steve Wagner posit in their legal treatise on fiduciary duties that it should be possible to include a provision narrowing and clarifying certain management and control rights, provided this is done carefully. As the authors explain, "it would appear that spouses-to-be, like partners-to-be, may be permitted to make some modifications to the duty of disclosure, duty of loyalty and duty of care, which can take place in premarital agreements if Corporations Code Section 16103 is deemed applicable to the negotiation and execution of premarital agreements."[12]

By way of example, if the parties wish to enter into an agreement that strengthens the independence of the separate property owners, they might wish to include provisions releasing the parties from the obligation to inform one another of prospective business or investment opportunities, as well as eliminating the obligation to allow the *other* party to either co-invest from his/her separate property or to offer the opportunity to the community first, before the separate property spouse takes advantage of it themselves. To my knowledge, there are no reported cases at present specifically upholding such a provision in a premarital agreement. However, spouses already have some freedom when it comes to the reasonable management and control of their separate assets.[13] *In re Marriage of Connolly,* the court stated "[w]e have repeatedly held that parties may elect to deal with each other at arms' length, and when they do so any fiduciary obligation otherwise owing is thereby terminated."[14]

What about Termination Provisions?

As mentioned above, the one operating agreement topic that is thoroughly addressed in almost all premarital agreements is what happens on divorce. Notwithstanding the fact that marriages are equally, if not more likely, to end with the death of one of the spouses rather than on divorce, many practitioners advise their clients not to include any death provisions at all or, worse yet, routinely include a provision that eradicates the probate code protections for spouses. The better prenuptial agreement, ideally prepared with the expert

assistance of estate planning counsel, squarely addresses the death issue.

Contracts to make a will, including provisions in a premarital agreement for gifts on death, are enforceable in the State of California.[15] Interestingly, while family law attorneys are busy trying to avoid these provisions, the majority of my clients are, if not eager, at least comfortable including this as a part of the agreement. Sometimes this is a place in the agreement where a party feels he or she can be generous—even with assets that are carefully segregated during life and on divorce. On the other end of the spectrum, there are those clients whose sole purpose in entering into a premarital agreement is to pave a smooth way for other heirs, children from a prior marriage for example, to inherit in lieu of the surviving spouse. Planning for what happens on death, whether that takes the form of an acknowledgment that there will be no inheritance at all, or a promise to make a particular gift or provision for the spouse's benefit, can be an important component of the couple's premarital agreement.

It is particularly important to include these types of provisions if, upon interviewing the client, it appears that promises relating to the estate plan have already been made and relied on. For example, on several occasions clients have told me they are comfortable waiving community property *because* they have been promised that a house or a specified amount of money is being left for them on the other person's death. This is an important deal point and should be an express part of the better premarital agreement. To ensure that these at-death promises are enforceable, a specific reference to them should be contained within the premarital agreement itself, thus ensuring that these provisions cannot be changed without both parties' knowledge and consent. However, this does not mean that family law attorneys should be drafting this language themselves. I strongly encourage family law practitioners to seek the input of estate planning lawyers when attempting to include "at death" provisions to avoid potential tax and ambiguity issues.

A second area to be mindful of when preparing the better prenuptial agreement is the waiver of family protections on death that are normally available to spouses under the Probate Code. These include the right to a probate homestead, a family allowance, and protections for omitted spouses, among other rights. It has become increasingly common practice for premarital agreements to simply waive all of these protections. While in some circumstances this may be entirely appropriate, in most cases it is not. These protections, designed by the legislature to provide financial security for family members pending the distribution of the estate and to protect spouses from unintentional disinheritance, can be vitally important. When such waivers are being proposed, each of the individual rights should be considered, understood, and weighed as part of negotiations. Again, if the family law drafter or reviewing attorney is not sufficiently familiar with the meaning and import of each of these rights, estate-planning counsel should be brought on board to assist.

One Size Does Not Fit All: Important Process Considerations

Traditionally, the premarital agreement is drafted by the attorney for one spouse, most often the wealthier of the two. Rarely does the couple discuss or negotiate the terms of the agreement in depth with one another directly. Often an awkward discussion or two will have occurred in which one spouse is essentially notified that "a prenuptial agreement" is being requested/demanded as a condition for marriage.

Similarly, rarely does the spouse requesting the premarital agreement spend significant time with his or her attorney getting educated about the options for the premarital agreement terms along the lines of the operating agreement analogy outlined above. Instead, it is simply presumed by the drafting attorney that the purpose of the agreement is to "protect" the assets of the wealthier spouse from the weaker spouse in the event of divorce. After the agreement is fully drafted, it is presented ready for signature to the other party and his or her attorney. A series of negotiations then sometimes takes place, often through the lawyers directly. At the end of the process, the agreement is signed, with the intention that the dreaded document be placed in a drawer or "box of hate," never to be needed or thought of again. As one blogger commented, "It doesn't take a rocket scientist to see the harm such a prenuptial agreement can do to a marriage. During the negotiations, feelings are harmed, generally irreparably… The feeling of being abused and marginalized persists throughout the marriage."[16]

In recent years, however, there has been a growing trend towards a more collaborative model for negotiating and drafting premarital agreements. In thinking about the better premarital agreement, it is important to choose professionals *willing* to educate both parties about these alternative options before any agreement is drafted and who are *able* to competently guide the parties through whatever process is appropriate for the particular case.

The two most common alternative approaches to the traditional model are the collaborative, or 4-way model, and the mediation, or 5-way model. In both of these approaches, frequently the expertise of other professionals, non-family law attorneys, is sought out. These can include estate planning advisors, tax advisors, mental health counselors (for communication, wealth and goal setting issues), and financial planners. Comparing the traditional process model and these more collaborative models, the two greatest differences are 1) moving the parties from the background to the foreground of negotiations over the agreement's terms, and 2) creating a customized agreement at the end of the discussions instead of starting from a presumptively correct complete draft that "protects" one party's interests over the other.

In the 4-way model, as described by Donna Beck Weaver in her excellent article on the topic, "[w]hen the collaborative process is used, the written agreement is prepared last, and only after the partners have discussed the issues and concerns important to them and their shared life, and have reached shared agreements about those concerns."[17] In the 4-way process, the parties meet with both the group and separately

with their own attorneys to complete the disclosures, and outline and negotiate the terms of the agreement. All of this happens before pen is put to paper so that, when both attorneys draft the agreement, the parties' mutual goals and interests are fully understood and implemented. As Weaver explains, "In the course of their four-way discussions, the couple can plan for the major foreseeable life transactions that are likely to occur during their marriage, such as acquisition of a family home, the bearing of children, the trajectory of careers, planning for the family's protection in the event of the disability or death of one of the partners. The process thus becomes a valuable exercise in thoughtful planning for the health and well-being of the marriage and the new family itself. It becomes far more than a paper moat around one party's separate property."[18]

In the 5-way model, a mediator is engaged to meet with the parties directly, most often without the attorneys present. The mediator acts as a neutral facilitator and information provider and assists with gathering the disclosure information and creating the first draft of the agreement. Parties still enlist the services of separate attorneys to help hone and refine their individual interests as well as to evaluate proposed agreement provisions, but this is generally done outside the mediation room. Again, the agreement is drafted at the end of the process. As with the 4-way model, the parties are educated together about the legal context, disclosures, and options for the agreement's terms. Any negotiations about substantive terms occur between the parties directly, since no attorneys are present to speak for them, and their conversation is facilitated by the neutral mediator. As summarized in a recent blog by Laurie Israel, "[m]ediation is an excellent way for people to resolve their differences and have clear communications. A mediator can help level the playing field, and elicit all thoughts and concerns of both parties in a non-confrontational setting. Mediating these conversations helps the clients discuss difficult issues without emotions, anger and hot speech overcoming them."[19]

Whether a particular premarital agreement should be negotiated and drafted using the traditional model, the 4-way collaborative model, the 5-way mediation model, or some hybrid approach depends on a number of factors, including: relative sophistication/bargaining power of the parties, cost concerns, and personalities/comfort level of the various professionals involved. The important thing for the practitioner seeking to assist couples with a better premarital agreement is to be aware that one size simply does not fit all. ■

---

* Thank you to Joan Ruskus, Ph.D., for expert assistance in survey design and analysis, and editing assistance by David Roessner, Ph.D. and Rita Patterson, J.D.

1 According to a 2013 online survey conducted by the American Academy of Matrimonial Lawyers of its nationwide membership, "63% of divorce attorneys cited an increase in prenuptial agreementtial agreements during the past three years…" *Increase of Prenuptial agreementtial Agreements Reflects Improving Economy and Real Estate Market: Survey of Nation's Top Matrimonial Attorneys Also Cites Rise in Women Requesting Prenuptial agreements*, October 16, 2013, http://www.aaml.org/about-the-academy/press/press-releases/pre-post-nuptial-agreements/increase-prenuptial agreementtial-re.

2 Ruskus, Geniveve,. *2015 Survey of Northern California Chapter of the American Academy of Matrimonial Lawyers.*

3 *Id.*

4 *Id.*

5 A recent study conducted by Heather Mahar, a fellow at the John M. Olin Center for Law, Economics and Business at Harvard Law School estimated that only between five to ten percent of marrying Americans get prenuptial agreementtial agreements. *For Many, Prenuptial agreements Seem to Predict Doom*, HARVARD UNIVERSITY GAZETTE, January 31, 2015, http://news.harvard.edu/gazette/2003/10.16/01-prenuptial agreement.html.

6 *Operating Agreements; The Basics," Small Business Administration*, January 27, 2015, https://www.sba.gov/blogs/operating-agreements-basics-0.

7 *Id.*

8 The community property states are Alaska, Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin.

9 *Comparing Equitable Distribution and Community Property for a Divorce*, LEGALZOOM DIVORCE EDUCATION CENTER, January 31, 2015, http://www.legalzoon.com/divorce-guide/equitable-distribution-community-property.html (emphasis added).

10 IRC § 1014(b)(6).

11 DAWN GRAY AND STEPHEN J. WAGNER, COMPLEX ISSUES IN CALIFORNIA FAMILY LAW- VOLUME B: FIDUCIARY DUTIES – A PRACTICAL APPROACH: HANDLING FIDUCIARY DUTY ISSUES IN THE DAY-TO-DAY PRACTICE OF FAMILY LAW B46-B414 (Matthew Bender 2005).

12 *Id.* at B4-12.

13 *See, e.g., Somps v. Somps.* 250 Cal. App. 2d 328 (1967). In upholding a trial court's ruling that husband's decision to purchase a property using his separate property, even though community assets were available, was *not* a breach of his fiduciary duty, the Court famously explained, "[t]he fact that husband purchased the … property with his separate funds, as the trial court found, is not evidence of taking any undue advantage nor is it a breach of a fiduciary relationship which would invoke a presumption of fraud or undue influence. There is no reason why husband should be compelled to keep his separate funds idle." *Id.* at 338.

14 23 Cal. 3d 590, 600 (1979).

15 CAL. PROB. CODE § 21700; CAL. FAM. CODE § 1612(a)(3).

16 *Is Mediating Prenuptial agreements a Form of Marital Mediation?*, THE HUFFINGTON POST, February 7, 2015, http://www.huffingtonpost.com/laurie-israel/is-mediating-prenuptial agreements-a-form-of-marital-mediation.html.

17 Donna Beck Weaver, *The Collaborative Law Process for Prenuptial agreementtial Agreements*, 4 PEPPERDINE DISP. RESOL. L. J., (Issue 3) 337, 340 (2004).

18 *Id.* at 341.

19 *Is Mediating Prenuptial agreements a Form of Marital Mediation?*, *supra* note xvii.

Risky Business—Drafting Limitations on Spousal Support in Prenups

Peter M. Walzer, CFLS | Los Angeles and Ventura Counties | pmw@walzermelcher.com

Peter M. Walzer is the founding partner of Walzer Melcher LLP. He is Chair of the Los Angeles County Bar Association Family Law section. He is a vice-president of the American Academy of Matrimonial Lawyers. Mr. Walzer is AV rated by Martindale Hubbell. He was president of the Association of Certified Family Law Specialists and a past chair of the Family Law Section of the State Bar of California.

In the year 2000, the California Supreme Court held in *Marriage of Pendleton & Fireman*[1] that under certain circumstances, parties could limit spousal support in premarital agreements. That decision set off a revolution in the world of prenups. Until *Pendleton*, many family lawyers believed that such clauses were not enforceable in California. Their reason: California had not opted into the Uniform Premarital Agreement Act's provision allowing a limitation on spousal support. In *Pendleton*, the Supreme Court upheld the waiver of support because the California Legislature had not explicitly opted *out* of the Uniform Act's section allowing limitations on spousal support.

Pendleton reasoned that "no public policy is violated by permitting enforcement of a waiver of spousal support executed by intelligent, well-educated persons, each of whom appears to be self-sufficient in property and earning ability, and both of whom have the advice of counsel regarding their rights and obligations as marital partners at the time they execute the waiver."[2] But what about couples who do not have the financial parity of the parties in *Pendleton*?

The Legislature responded swiftly to the *Pendleton* decision. It enacted SB78 into law, effective 1/1/2002, as Family Code section 1612(c) and rewrote Family Code section 1615. Now, although limitations of spousal support may be valid, the trial court is required to determine whether enforcing the limitation would be "unconscionable at the time of enforcement."

Pendleton and the Legislature's reaction to it gave California lawyers little clarity. What does "unconscionable" mean as used in Family Code section 1612(c)? Lawyers have been drafting spousal-support limitation clauses since *Pendleton*, but the parties and the lawyers do not know at the time of signing if these provisions will be enforceable when the marriage breaks down—perhaps years later. Every prenup with such a provision is a gamble. Do the odds of winning the gamble improve if the waiver is less than a complete waiver? Is a full waiver of spousal support more likely to be found unconscionable than a limited waiver?

There are various ways to provide for limited spousal support. The parties can agree, for example, that the high earner will provide the low earner with a place to live, health insurance, and other necessities. But there is no assurance that even this limitation will not be found unconscionable. Limitations can also be drafted as a specific amount of money, such as John will pay Cathy $7,500 per month in tax deductible spousal support as long as he is earning more than $400,000 per year. You might draft the limitation as a cap on the amount of spousal support your client would pay. For example, the agreement can provide: "If spousal support is ordered, it will be no more than $10,000 per month." Yet, even that clause is a gamble. The party is still betting that a court will not find $10,000 per month to be unconscionable. The odds may still be better than they would for a full waiver. In determining what the cap should be, the party requesting the limitation could ensure that the receiving party's needs are met. The lawyer drafting a limitation on spousal support should advise the client that *any* limitation could be set aside as unconscionable. But plan for the reversal of fortune. Sometimes the lawyer drafting the agreement does not take into account that the dependent spouse may be successful financially while the spouse who is well off may become the needy spouse.

The first case to give us an inkling of what may be in store was *In re Marriage of Facter.*[3]

Although *Facter* addressed the validity of pre-2002 agreement that contained a full waiver of spousal support, the decision may have implications for agreements drafted after 2002. In determining whether the waiver was unconscionable, the *Facter* court considered the length of the marriage (sixteen years), how the wife used her time during the marriage (raising children and not educating herself or

working) and compared what she did to the husband's work during the marriage (he pursued a financially rewarding career).[4] The court also took into consideration that the wife would never come close to replicating the marital standard of living.[5]

The court looked at her property settlement and remarked, "compared to what she is likely to receive in court-ordered spousal support, these assets are manifestly inadequate."[6]

In addition, the court concluded, "[g]iven that Jeffrey's self-reported separate property is now in excess of $10 million and his earnings $1 million per year, whereas Nancy amassed no separate property during the marriage and has no income at all, we have little difficulty in concluding that the Agreement's spousal support waiver is presently unconscionable."[7]

This language dealt with the law before 2002 and may not be relevant to modern prenups drafted pursuant to Family Code section 1612(c).

Most states allow parties to limit spousal support, subject to the court's power not to enforce the agreement under certain circumstances. Of the twenty-seven jurisdictions that have enacted the Uniform Premarital Agreement Act (UPAA),[8] twenty-four allow the parties to limit spousal support, subject only to the court's authority to make an award sufficient to keep a dependent spouse off welfare or to prevent undue hardship. As for states that have not adopted the UPAA, spousal-support waivers are nonetheless allowed under certain circumstances. A minority of states do not allow spousal-support waivers and in the rest of the states, there is no authority on the subject.

Among UPAA states, most may refuse enforcement if the waiver would make the claimant eligible for public assistance. Some states have liberalized this rule to allow a showing that the spousal-support claimant will suffer undue and unforeseeable hardship. Fifteen states are called "second-look" states because the court can determine at the time of divorce whether the **entire agreement** is unconscionable. Although California is not a "second-look" state as to the agreement as a whole, our courts can examine the spousal-support limitation and determine if the limitation is unconscionable.

In *Premarital Agreements, Drafting and Negotiation*,[9] Linda Ravdin points out that there are several questions a court may ask in determining whether a limitation clause is unconscionable:

- What level of hardship must the claimant experience to warrant an award?
- Must the circumstances have changed since execution of the agreement?
- Must changed circumstances have been unforeseeable?
- When an award is appropriate, what are the criteria for determining the amount and duration?

Gross v. Gross,[10] an Ohio case, deemed a waiver unconscionable because it would compel the wife to accept a post-divorce standard of living much lower than the opulent standard of living she enjoyed during the marriage. Despite this finding, the support award in the case was a small percentage of the husband's income and it was not sufficient to allow the wife to continue her accustomed standard of living. (Ohio is an equitable distribution state and the court has discretion to allocate marital property equitably.) This case indicates that although the court may not enforce the limitation on spousal support, it could take the limitation into consideration in setting the amount of spousal support. California Family Code section 4320 lists the factors that a court should consider in setting spousal support. The factors do not include the existence or non-existence of an agreement of the parties limiting support, but it does include a catch-all provision that allows the court to consider any other factors that are "just and equitable." It is possible that a court could invalidate a spousal-support limitation clause in a premarital agreement as unconscionable, but could consider that clause as a factor in setting the amount and duration of spousal support.

Although spousal-support limitation clauses have been allowed in California for fifteen years, it may take much longer for the law to give us guidance on what kind of limitation will be enforceable. For now, parties cannot be sure whether their limitation clauses will be enforceable at the time of divorce. Until then, lawyers should advise their clients to keep some concept of fairness in mind in negotiating these clauses. It does not matter if a limitation clause is "fair" now; it must not be unconscionable 20 years from now—at the time of divorce. To determine that, look into your crystal ball. It will be a lot clearer than the law. ■

---

1 24 Cal. 4th 39 (2000).
2 *Id.* at 53.
3 212 Cal. App. 4th 967 (2013).
4 *Id.* at 983.
5 *Id.*
6 *Id.*
7 *Id.*
8 UNIFORM PREMARITAL AGREEMENT ACT, 9C U.L.A. 35 (2001), *available at* http://http://www.uniformlaws.org (last visited March 26, 2015).
9 Linda Ravdin, *Premarital Agreements, Drafting and Negotiation*, ABA, SECTION OF FAMILY LAW, 2011, at 84.
10 11 Ohio St. 3d 99 (1984)

Attorneys as Escrow Holders or, "No Problem. We'll Just Deposit the Sale Proceeds into my Trust Account."

Robert Marmor, CFLS | Sonoma County | robertmarmorlaw@gmail.com

Robert Marmor has been honored by his peers as a Northern California Super Lawyer, placing him among the top 5 percent of attorneys in the region. Robert handles divorce cases involving complex issues of property, child custody, child and spousal support, restraining orders, and guardianship.

It's just another day at my office. Let's assume that my client (let's call her Judith) calls me with the good news that a buyer wants the Witkin Avenue residence that she and her husband, Stephen, jointly own. It's mid-case. Judith asks me if I will hold the anticipated $250,000 in sale proceeds in my trust account until the remaining issues in her case are settled. I've done that before for clients but never involving anything close to $250,000. She says that Stephen trusts me and that he's okay with me holding the funds in trust. I like my client and I want to say yes, no problem. Something tells me, though, to proceed with caution. I just don't know what I don't know.

Attorneys often serve as escrow holders. We agree to temporarily hold funds of the parties in our cases. We hold not just funds but also deeds, stock certificates, and other important papers pending satisfaction of certain agreed conditions. We are exempt under state law from the licensing rules that would otherwise apply to us as escrow holders. *See* Cal. Fin. Code § 17006(a)(2). We are accustomed to matters going smoothly in our handling of escrowed property. They generally do. But California case law (including cases involving damage suits and attorney discipline cases) informs us that not every attorney escrow in California has gone well. The purpose of this article is not to alarm the reader. It is to alert the reader to some of the potential pitfalls that could, at least in theory, await the attorney escrow holder; to suggest ways to minimize risk to the attorney who provides escrow services; and, to suggest some practical options to the attorney asked to serve as escrow holder.

The author does not claim to have all of the answers to the legal and ethical questions that arise when an attorney agrees to serve as escrow holder. The absence of clear guidelines is, in itself, a reason for caution when an attorney is asked to provide escrow services. Although there are California State Bar ethics opinions to guide us, and reported cases that have dealt with situations where attorneys have served as escrow holders, many unanswered questions remain.

What should I be asking myself before agreeing to serve as escrow holder? Some of the issues addressed in this article are:

- If I agree to hold in trust funds belonging to both sides, am I an escrow holder? If all I do is agree to hold a deed sent to me by opposing counsel, am I nevertheless, an escrow holder?
- If I'm an escrow holder, what are my duties to the party on the other side of the case? What are the ramifications of assuming fiduciary duties to both my own client and the opposing party with respect to the subject matter of the escrow?
- Do I have to have a written agreement to serve as an escrow holder? If I don't have a written agreement, have I violated the Rules of Professional Conduct?
- Do the Rules of Professional Conduct require that I notify my client of the conflict of interest in serving as escrow holder? Do the Rules require that I obtain my client's written consent? Just what do the Rules require that I disclose?
- If a dispute arises over the funds that I hold in escrow, am I permitted to represent my client in a dispute over the funds I hold without the written consent of the other party to the escrow to whom I owe a fiduciary duty?
- If I recommend that the parties deposit jointly owned funds into an account requiring two signatures to withdraw funds, is my client adequately protected? Is the bank responsible if a mistake is made and funds are withdrawn with just one signature? What do I need to tell my client to protect myself?
- If I decide that I don't want to be in the position of escrow holder, is there another option, perhaps a licensed company that will serve as the escrow holder for a fee?

- Does my malpractice insurance cover me if I am sued by the party to the escrow whom I don't represent?

The scenarios that follow are intended to illustrate certain important considerations the attorney who has been asked to provide escrow services should bear in mind.

SCENARIO ONE: EASY. ALL I HAVE TO DO IS DEPOSIT THE FUNDS IN TRUST. RIGHT?

My client, Judith, calls me. She tells me about the pending sale of the Witkin Avenue residence. I believe that the sale is very much in Judith's best interest. I'm aware of the importance of safeguarding the $250,000 net proceeds of the sale after the close of escrow and until the issues in the case are resolved. The case has gone smoothly and amicably. I have a good working relationship with Stephen's attorney. I've never had a problem holding funds in trust under similar circumstances in the past. I agree to hold the funds in trust. I receive a letter from Stephen's attorney expressing consent to my serving as escrow holder pending written agreement of the parties for disposition of the funds or order of the court. I set up a trust account at a bank to receive the funds, receive the $250,000 proceeds of sale, then, without further ado, I deposit the $250,000 into the trust account. For reasons discussed below, by doing this, I have probably just violated the Rules of Professional Conduct.

THE ATTORNEY WHO HOLDS FUNDS IN TRUST FOR THE CLIENT BECOMES AN ESCROW HOLDER. AS ESCROW HOLDER, THE ATTORNEY OWES FIDUCIARY DUTIES TO BOTH THE CLIENT AND TO THE THIRD PARTY CO-OWNER OF THE ESCROWED FUNDS.

The court of appeal in the case of *Peterson Development Company, Inc. v. Torrey Pines Bank* defined an escrow as, "a transaction in which one person, for the purpose of effecting a sale, transfer or encumbrance of real or personal property to another person, delivers any written instrument, money, evidence of title or other thing of value to a third party, the escrow holder or depository, to be held by him for ultimate transmittal to the other person upon the happening of an event or the performance of certain specified conditions." 233 Cal. App. 3d 103, 118 (1991) (citation omitted). The court continued, "[t]he usual purpose that prompts the creation of an escrow is the desire of persons dealing at arm's-length with each other to have their conflicting interests handled by one person in such a manner as to adequately protect the rights of each of the parties to the transaction" *Id.* (citation omitted).

Applying the above definition of an escrow, the attorney who holds funds for his/her client and for the spouse of his/her client for the purpose of affecting the sale of the parties' real property serves as an escrow holder.

The attorney who serves as an escrow holder owes a fiduciary duty to both his or her client and to that client's spouse. The case *Virtanen v. O'Connell* dramatically illustrates the point. *See* 140 Cal. App. 4th 688 (2006). In that case, attorney O'Connell represented the buyer of stock and agreed to serve as the escrow holder in the transfer of the stock from Virtanen to O'Connell's client. *Id.* A detailed stock purchase agreement was signed and Virtanen's attorney delivered the share certificates to O'Connell together with a cover letter specifying the conditions under which O'Connell was authorized to deliver the certificates to O'Connell's client. *Id.* Thereafter, Virtanen rescinded the transaction. *Id.* Despite the rescission and in contravention of the terms of the conditional delivery of the certificates to him, O'Connell delivered the certificates to the transfer agent for delivery to O'Connell's client. *Id.* A jury later found that O'Connell and his law firm had converted the shares of stock. *Id.* A judgment of $1,985,000 plus costs was entered against O'Connell and his firm. *Id.* The court of appeal said, "'[a]n escrow holder is the agent of all the parties to the escrow at all times prior to performance of the conditions of the escrow [citations]; bears a fiduciary relationship to each of them [citation]; and owes an obligation to each measured by an application of the ordinary principles of agency.'" *Id.* (quoting *Diaz v. United California Bank*, 71 Cal. App. 3d 161, 168 (1977)) "Although [O'Connell] owed [Virtanen] no professional duty, his acceptance of [Virtanen's stock certificates gave] rise to a duty of care. The wellspring of this duty is the fiduciary role of an escrow holder. [Citations.] The fiduciary obligations of an escrow holder, and an attorney acting as an escrow holder, are well settled." *Id.* at 703.

RULE OF PROFESSIONAL CONDUCT 3-310 "AVOIDING THE REPRESENTATION OF ADVERSE INTERESTS"

Rule 3-310(B) provides in pertinent part:

> *(B) A member shall not accept or continue representation of a client without providing written disclosure to the client where:*
>
> > *(1) The member has a legal, business, financial, professional, or personal relationship with a party or witness in the same matter;*
> >
> > …
> >
> > …

Rule 3-310(C) provides in pertinent part:

> *C) A member shall not, without the informed written consent of each client:*
>
> > *(1) Accept representation of more than one client in a matter in which the interests of the clients potentially conflict; or*
> >
> > *(2) Accept or continue representation of more than one client in a matter in which the interests of the clients actually conflict; or*
> >
> > …

Recall that in this scenario, I agreed to hold the proceeds of sale of the Witkin Avenue residence in trust for the parties, received instructions from Stephen's attorney, and, without more, I deposited the proceeds of sale in trust. I believe that, in so doing, I violated Rule of Professional Conduct 3-310(B) and 3-310(C). Here's why: In holding the funds in trust, I became an escrow holder. As escrow holder, I assumed a fiduciary duty not only to my own client but also to Judith's husband, Stephen. Upon assuming a fiduciary duty to Stephen, I failed to disclose the conflict to my client, Judith. I also failed to obtain Judith's written consent.

The fact that I am not Stephen's attorney does not preclude application of Rule 3-310. The Court of Appeal in the case of *American Airlines, Inc. v. Sheppard, Mullin, Richter & Hampton*, addressing Rule 3-310(C) said, "[a]pplication of Rule 3-310(C) does not require representation of both clients *as an attorney*. The discussion section which follows Rule 3-310 states: 'Subparagraphs (C)(1) and (C)(2) are intended to apply to all types of legal employment, including the concurrent representation of multiple parties in litigation or in a single transaction or in some other common enterprise or legal relationship.'" 96 Cal. App. 4th 1017, 1032-33 (2002).

How, in the real world, might such a conflict between my client and the other party to the escrow arise? A plausible scenario: Let's assume that I deposited the $250,000 proceeds of sale into the trust account; that Judith calls me to tell me that she has just learned that Stephen secretly drained $100,000 from a community property investment account; and Judith instructs me to take $50,000 of the $250,000 I hold in trust and pay the $50,000 to her. She provides me with irrefutable documentation that she is correct. Stephen, through his attorney, objects to the removal of any funds from the trust account without Stephen's written consent or court order. Judith insists that, as her attorney, I have a duty to pay the funds over to her. At that point, I explain to her, for the first time, that I have a conflict of interest; that I have a fiduciary duty to Stephen not to release funds over his objection; and that, in the absence of Stephen's written consent to the release of funds or a court order, I cannot comply with her instructions for the release of funds to her. She is very upset. It seems to her that she has provided proof that the $50,000 should be paid to her and that my duty to her as her attorney comes before any duty that I have to Stephen. She's also upset that I never explained these things to her before I agreed to serve as escrow holder. I review Rules 3-310(B) and (C) and realize that I failed to disclose the conflict of interest and to obtain Judith's written consent to proceed despite the conflict. For the first time in my career, I'm very worried that I could be in trouble with the State Bar.

SCENARIO TWO: OFF TO COURT TO REPRESENT MY CLIENT IN A DISPUTE OVER ESCROWED FUNDS—OR, MAYBE, I CAN'T DO THAT. MIGHT I NOW HAVE A STATE BAR PROBLEM?

Let's assume it's my client, Judith's, divorce case as described above. Assume that I prepared and the parties and counsel signed an agreement by which I am authorized to hold the $250,000 in trust pending written agreement of the parties or order of the court. I disclosed in the agreement that in serving as an escrow holder, I owe a fiduciary duty to both parties and that, because I owe them both a fiduciary duty with respect to the escrowed funds, I have a conflict of interest. I obtained in the agreement the express written consent of both parties to proceed as escrow holder despite the conflict of interest. Let's assume that in so doing, I believe that I have fully complied with Rule 3-310.

Next comes the immutable, "It's always something" rule of the practice of law. Judith calls me to tell me she has learned that Stephen secretly drained $100,000 from a community property investment account. She wants $50,000 from Stephen's share of escrowed funds. I explain that a court order will be needed to obtain compensation for her from Stephen's share of the funds. I inform Stephen's attorney that I intend to proceed with a Request for Order seeking authorization to release the funds to Judith. Stephen's attorney objects. He takes the position that I may not represent Judith in such a proceeding that involves the funds I hold in escrow without violating my fiduciary duty to Stephen. He says that if I wanted to preserve the right to represent Judith in any dispute over the funds that I hold in escrow, I should have addressed that in the written escrow agreement and obtained Stephen's consent in that document.

Might Stephen's attorney be correct? After all, I acknowledge that I have a fiduciary duty to both parties as to the escrowed funds. Might a judge find that representing Judith in a contest over the funds is inconsistent with my fiduciary duty to Stephen? I do the research but can't find anything directly on point in reported California authorities. I do, however, find language right on point in an ethics opinion by the Committee on Professional and Judicial Ethics of the New York City Bar. After reading the opinion, although dealing with New York law, I am impressed by its logic. I take Stephen's attorney's position more seriously. In Formal Opinion 1986-5, the Committee stated:

> As a general rule, it is ethically permissible for a lawyer to represent a client and to act as escrow agent in the same transaction if all interested parties have consented after full disclosure by the lawyer of the possible effect of his dual role on the interests of each party, and if it is obvious that the lawyer can adequately represent the interests of all parties. See DR 5-105(C); N.Y. County 573 (1969). Such consent must be fully informed. *A consent based upon the contemplated discharge of routine escrow instructions, without taking into account potential disputes among the parties, is not sufficient to override a conflict of interest in the event of a dispute.*
>
> It is advisable therefore, to include in the escrow agreement carefully drafted provisions making clear that the non-client party agrees that, in the event of a dispute between the parties with respect to the escrow or the underlying transaction, the lawyer may represent his client in the dispute. Such a provision clarifies the scope of the non-client's consent and therefore lessens the likelihood of confusion and delay that might be caused by the lawyer's attempting to obtain such consent after a dispute occurs, or having to resign as escrow agent or being disqualified from representing his client.

Lawyer as Escrow Agent, Formal Opinion 1986-5 (N.Y. City Bar, Comm. on Prof'l and Judicial Ethics, July 14, 1986) (emphasis added) (citation omitted).

I tell Judith that I'm not certain how a judge would rule on the issue of whether I may represent her in a dispute over release of escrowed funds to her. Judith is upset that I failed

to warn her that I might not be able to represent her in a dispute over the funds. Now I'm also worried that I may have had a duty to disclose to my client that I might not be able to represent her in the event of a dispute over the escrowed funds. I research the Rules of Professional Conduct and find Rule of Professional Conduct 3-310(A)(1) which provides, "(A) For purposes of this rule: (1) 'Disclosure' means informing the client or former client of the relevant circumstances and of the actual and reasonably foreseeable adverse consequences to the client or former client." It seems to me that, in the absence of a provision in the agreement allowing me to represent Judith in a dispute over escrowed funds, I may have had a duty under Rule 3-310(A)(1) to disclose to Judith the potential problem in representing her in any such dispute.

SCENARIO THREE: I HOLD THE DEED AS ESCROW HOLDER THEN REFUSE MY CLIENT'S DEMAND TO DELIVER THE DEED TO HER.

It's post judgment. In this scenario, assume that the marital settlement agreement provides that Judith will keep the Witkin Avenue residence; that she will pay Stephen $125,000 for his interest; and that Stephen will provide Judith with an Interspousal Transfer Deed in exchange for payment to him of the $125,000. Stephen's attorney sends me a letter enclosing the deed and instructing me to deliver the deed to Judith only when I hold her check payable to Stephen for $125,000. Without giving it much thought, I decide that I don't need a written agreement signed by the parties authorizing me to serve as escrow holder as to the deed. Why would a written agreement be needed when all I'm asked to do is hold a deed until certain conditions are satisfied? Next, Judith tells me that Stephen has failed to pay a $50,000 debt that he was ordered by the judgment to pay and that the creditor required her to pay the $50,000, which she did to avoid being sued. She provides me with solid proof. She credits herself with the $50,000, provides me with a check for Stephen in the amount of $75,000, and asks me to turn over the deed to her. Something tells me that, even though I'm sure that Judith only owes Stephen $75,000, there could be a problem if I turn the deed over to Judith without Stephen's consent.

I research my duties. I review the *Vertanen* case (*supra*) in which attorney O'Connell took possession of Mr. Vertanen's share certificates as escrow holder and then was successfully sued for wrongfully turning the certificates over to his client. I also find the case of *Wasmann v. Seidenberg*. 202 Cal. App. 3d 752 (1988). In that case, attorney Peter Seidenberg represented Wife in her divorce case. *Id.* Husband's (Wasmann's) attorney sent Mr. Seidenberg a final draft property settlement and a grant deed signed by Husband together with a letter authorizing recordation of the deed only when Seidenberg provided the agreed amount of consideration to Husband. Wife obtained the grant deed and recorded it without paying Husband. *Id.* Husband sued Seidenberg. *Id.* The Court of Appeal said:

> Having accepted the deed from Wasmann, Seidenberg was bound to comply strictly with the escrow instructions. Specifically, he was obligated to prevent recordation of the deed until Barbara deposited into escrow the sum due to Wasmann. Violation of an escrow instruction gives rise to an action for breach of contract; similarly, negligent performance by an escrow holder creates liability in tort for breach of duty.

Id. at 756 (citations omitted).

Based upon my research, I conclude that having accepted the deed and having received the letter of instructions of Stephen's attorney, I, like attorneys O'Connell and Seidenberg, in fact, took on the role of escrow holder. I now realize that I have a legal duty to Stephen not to turn over the deed to Judith without Stephen's consent or an order of the court. I realize that even though I accepted a deed as distinguished from money belonging to the parties, I am, nevertheless, serving as an escrow holder. Now I wish that I had given more thought to the matter before I agreed to hold the deed. I conclude that I should have had a written agreement to serve as escrow holder, should have disclosed to Judith the conflict of interest that I undertook in agreeing to hold the deed, and should have obtained Judith's written consent to the conflict of interest. I wish I had told Judith that I might not be able to turn over the deed to her without Stephen's consent or court order in the event of a dispute between Judith and Stephen regarding the subject matter of the escrow. I also wish that I had obtained the consent of both parties to represent Judith in contested proceedings relating to the escrow.

Query whether the result would be the same if the judgment had provided that Stephen was to provide the deed to me, that Judith was to provide the $125,000 payment to me, and that I was then to deliver the $125,000 payment to Stephen and release the deed to Judith. Perhaps, under those circumstances, I would not have assumed the role of escrow holder with the attendant duties.

SCENARIO FOUR: I SUGGEST THAT JUDITH TRY TO REACH AN AGREEMENT WITH STEPHEN TO DEPOSIT THE NET PROCEEDS OF SALE OF THE WITKIN AVENUE RESIDENCE INTO AN ACCOUNT REQUIRING TWO SIGNATURES FOR WITHDRAWAL.

In this scenario, it's mid-case. Judith calls me with the good news about the sale of the house. My instincts tell me to avoid holding the proceeds of sale of the Witkin Avenue residence in trust myself. I recommend to Judith that she try to reach an agreement with Stephen to deposit the proceeds of sale into a bank account requiring the signature of both parties to withdraw. Judith calls me back a few weeks later to tell me that Stephen agreed to open an account requiring two signatures to withdraw funds. She's not happy, though, that she called more than ten banks before she found one that would set up that type of account. I was unaware that most banks no longer offer two-signature accounts. Three months later, Judith calls me to tell me that Stephen has unilaterally withdrawn all of the funds from the account that was supposed to require two signatures for withdrawal. She says the bank acknowledges its error in allowing the withdrawal on only Stephen's signature, sincerely apologizes, but disclaims any responsibility on the

basis of the terms of the written agreement under which the account was opened. That agreement, in the small print, absolves the bank of liability in the event it inadvertently releases funds on only one signature. Judith is disappointed that, when I suggested an account requiring two signatures to withdraw funds, I didn't warn her that she would not have recourse against the bank if it mistakenly released funds on just one signature.

SCENARIO FIVE: I DON'T WANT TO SERVE AS ESCROW HOLDER. I'M SURE THAT THERE MUST BE SOME OTHER WAY TO HOLD FUNDS IN AN ESCROW PENDING WRITTEN AGREEMENT OF THE PARTIES OR ORDER OF THE COURT.

Fortunately, I'm right. After some online looking, I discover that there are private escrow companies in California licensed by the California Department of Business Oversight that will provide professional escrow services for a fee. I suggest to Judith that she research these companies online, identify several to check out, find out what she can about each of them, and ask each one about the fees they would charge for escrow services in her situation. I tell Judith that the charges quoted can be steep. I urge her to ask whether the charges are negotiable.

SCENARIO SIX: STEPHEN IS ANGRY ENOUGH AT ME TO SUE ME. WILL MY MALPRACTICE INSURANCE COVER THE CLAIM?

Let's assume in this scenario that Judith is transferring title to the Witkin Avenue residence to Stephen in return for Stephen's payment of $125,000 to Judith. I have agreed in a writing signed by Judith, Stephen, opposing counsel, and by me that, as a condition of releasing funds to Judith, I will obtain the signed deed from Judith, warranties to the various appliances remaining in the house, the remote for the garage, and two sets of keys to the house. I do all that I'm supposed to do, release the deed to Stephen, transfer Stephen's $125,000 check to Judith, and close my file. Next, I receive a letter from a new attorney, a plaintiff's tort attorney, who represents Stephen. Stephen claims that a retaining wall at the home has failed and that expensive repairs are needed. Stephen says that Judith told him that she had informed me about the problem with the retaining wall and thought I had informed Stephen's attorney. Stephen claims that as escrow holder, I had a fiduciary duty to him to disclose all significant information I knew relating to the real property subject to the escrow. I know that my malpractice insurance will cover claims by my own client. I'm not so sure about coverage if Stephen sues me. I call my carrier. I am told that whether I'm covered may depend upon how the complaint is framed. If the complaint alleges only that I breached the escrow contract, I might not be covered. If the complaint alleges that I negligently handled escrow services, I probably will be covered. (Author's note: What I've said about possible coverage is based on a conversation I had with my own carrier when I said I was writing this article and asked about coverage under my own policy if I were to serve as an escrow holder. I have not completed an industry-wide survey. I raise the question of insurance coverage in escrow situations but do not have general answers. I cannot begin to answer the coverage question for you, the reader.)

I could change the scenario to hold back $50,000 at Judith's request, or introduce other complications. The uncertainty about insurance coverage grows.

WHAT SHOULD THE ATTORNEY WHO WILL SERVE AS ESCROW HOLDER CONSIDER INCLUDING IN A WRITTEN ESCROW AGREEMENT?

Following are my suggestions (certainly not a complete list) for provisions to include in a written agreement for an attorney to serve as escrow holder:

- Disclose the relevant circumstances and the actual and reasonably foreseeable adverse consequences to the client. (Rule 3-310(A))
- Clearly describe what the attorney as escrow holder is to do and all specific conditions of the escrow. (Rule 3-300(A))
- Advise the client that he/she should consult an independent attorney with respect to the written agreement. (Rule 3-300(B))
- Disclose that the attorney assumes a fiduciary duty to each party as to the subject matter of the escrow; that having a fiduciary duty to both parties creates an inherent conflict of interest; that both parties are aware of the conflict of interest and expressly waive that conflict (Rule 3-310(B) and (C)); that the attorney must comply with the terms of the written escrow agreement; and that the attorney will not be able to comply with any unilateral instructions of either party that are inconsistent with the provisions of the escrow agreement or the written instructions of the other party.
- Disclose that in the event of a dispute between the parties with respect to the subject matter of the escrow the attorney-escrow holder may have to seek instructions from the court by way of a Request for Order or interpleader. If the attorney-escrow holder intends to look to escrowed funds for payment of reasonable fees arising from any such court proceedings, the intent should be clearly stated.
- Disclose that the attorney will continue to serve as attorney for the client at the same time as serving as escrow holder.
- Disclose that assuming fiduciary duties to both parties might compete with the attorney's fiduciary duties to the attorney's client.
- Provide that, in the event of any dispute over the subject matter of the escrow, the parties to the escrow agree that the attorney-escrow holder may represent the client of that attorney in the dispute and, that the parties waive the conflict of interest.
- If the attorney-escrow holder will look to escrowed funds for payment of fees, describe in detail how such fees will be charged, against whose share of funds fees will be charged, and other relevant details.

(The author thanks attorney Ellen R. Peck who wrote about attorneys providing escrow services and, in particular, the question of provisions to include in an attorney escrow agreement in an article titled "Duties to Third Parties" that appeared in the February 2007 edition of the California Bar Journal.)

CONCLUSION

After doing the research necessary for this article, I very much doubt that I will agree to serve as escrow holder of funds in my cases. I will probably suggest that my client find a licensed escrow company to handle the escrow. In making that suggestion, I will urge my client to contact several such companies to compare fees charged and to ask each company contacted about the negotiability of fees. If I do decide to serve as escrow holder, I will carefully draft the written escrow agreement. Finally, even if I simply agree with opposing counsel to hold a deed pending satisfaction of some condition, I will carefully consider the implications of serving as attorney-escrow holder as to the deed.

I cannot answer the question of what you the reader should do if asked to serve as attorney-escrow holder. The purpose of this article is only to provide you with food for thought. ■

Upcoming Chapter Programs

Bay Area Chapter:

June 9, 2015

Ron Granberg, CFLS, John Harding, CFLS, and Los Angeles forensic accountant Mark Luttrell will present "Cash Flow Games People Play."

Social hour starts at 6:00 PM
Main Program Starts at 7:00 PM

Scott's Seafood Restaurant
1333 N. California Blvd.
Walnut Creek, CA 94596

October 5, 2015

SPECIAL PROGRAM—"The Great GILLMORE Debate!"

1:00 PM to 4:00 PM at the JAMS San Francisco Conference Room.

Limited seating for a chance to hear QDRO experts (QDRONES) argue the influence of In re Marriage of Gillmore (1981) over benefits division in 2015. Retired Justice Sheila Sonenshine will preside. Details will follow in the coming months.

These programs would not be possible without the tireless efforts of Board Members Anne Davies and Sherry Peterson.

Sacramento Chapter:

August 25, 2015

Tracy Duell-Cazes, CFLS and Fredrick S. (Rick) Cohen, CFLS will co-present "Prosecuting and Defending Contempt: The Litigators' Viewpoints."

September 22, 2015

Kimball Sargeant, CALS and Linda Conrad, CALS will co-present "Statement of Decisions: Nuts and Bolts of Drafting the Request and Proposals as to Content."

October 23, 2015

Ronald Granberg, CFLS on "Evidence," a three-hour program.

Orange County Chapter:

The 2015 Orange County Chapter of ACFLS Speakers Series, *"The Anatomy of a Family Law Trial"* continues with its quarterly presentations on the following dates with the following presentations:

June 29, 2015

Panel Two: "Tender the Expert: Direct and Cross-Examination of Expert"
Panelists: Commissioner David S. Weinberg (Ret.), Philip G. Seastrom, Steven E. Briggs

September 21, 2015

Panel Three: "Call Your First Witness: Direct and Cross-Examination of Non-Expert Witnesses"
Panelists: Judge Mark S. Millard, Eleanor A. Stegmeier, Suzanne Harris

November 16, 2015

Panel Four: "It's All in the Way You Tell It: Closing Argument and Post-Trial Motions"
Panelists: Judge Kenneth Black (Ret.), Edward Thomas, Saul Gelbart

All presentations are at Whittier Law School from 6:00 p.m. – 8:00 p.m., with a buffet dinner from 5:00 p.m. – 6:00 p.m.

Tax Relief for Injured and Innocent Spouses

Kneave Riggall* | Los Angeles County | krtaxlaw@yahoo.com

I am an attorney and certified tax law specialist in private practice in South Pasadena, California. My practice focuses on: Tax controversies, such as audits, appeals, immunity for tax crimes, injured and innocent spouse matters, levies, liens, appeals, installment payment plan requests, offers in compromise, and voluntary disclosures; tax planning, including projecting taxes and writing tax opinion letters; tax whistleblowing, from evaluating and preparing tax informant reward claims to representing whistleblowers before the IRS and United States Tax Court; and tax litigation, including serving as special tax counsel in Bankruptcy Court and as an expert witness on taxes.

I. Introduction

By filing "a single return jointly of income taxes,"[1] instead of two "married filing separately" returns, married taxpayers **usually** reduce their preparation expenses and **federal** income taxes.[2] One cost offsetting those savings is that any overpayment of tax on a joint return that is encumbered by certain premarital debts of either spouse. Another cost is the joint and several liability[3] of each spouse for taxes due on the joint returns they signed. Here are fifteen ways that California and federal tax law can reduce, or even eliminate, those taxes and costs for injured and innocent spouses.

II. Injured Spouses

A spouse is an "injured spouse" if he or she files a joint tax return that shows taxes were overpaid, and then has some or all of his or her share of that overpayment "offset," by the IRS, to pay certain of her spouse's debts that were incurred **before** their marriage. Those debts include legally enforceable: unpaid federal or state tax, plus interest, penalty, or other addition to such tax;[4] child or spousal support;[5] debts (including student loans) owed to another federal agency;[6] overpayments of Old Age, Survivors and Disability Insurance benefits;[7] state income taxes;[8] and certain overpayments of state unemployment compensation.[9]

To prevent the taking of an injured spouse's share of federal tax overpayments, he or she must complete a Form 8379 and attach it to each and every federal joint income tax return he or she files. That same form can be used to make a refund claim. Unfortunately, "California does not have an injured spouse provision."[10]

To illustrate, assume that Greta Clew married Joe Kerr in 2013. In September 2014, they filed a joint 2013 United States income tax return, which showed that they had overpaid their federal income taxes by $8,000. Last week, they received a notice from the Internal Revenue Service[11] that their federal overpayment would be applied to Joe's unpaid child support. By filing a Form 8379, Greta can get $4,000 of that 2013 overpayment back from the IRS. Further, if Greta attaches a new Form 8379 to each of the Kerrs' future joint 1040s, then she will get a refund equal to half of each year's overpayment.

III. Innocent Spouses

The Internal Revenue Code recognizes three types of "innocent spouse": A spouse who filed a joint return **and then discovered** that his or her spouse has omitted income from, or falsely claimed deductions or credits on, that return; a spouse who signed a joint return that understated the tax owed and is now divorced, legally separated from, or no longer living with her/his co-filer; and a spouse whom it would be inequitable to hold liable for a tax owed on a joint return they filed. California law virtually copies federal law regarding tax relief for those three types of innocent spouses and will accept an IRS determination as final for state purposes.[12] California also authorizes California courts, in limited circumstances, to revise the joint California income liabilities of a divorcing couple.[13]

Any innocent spouse can obtain relief from any tax, interest, penalty, or other amount owed on a filed joint return[14] because his or her spouse failed to report income, or wrongly reported a property's basis, a tax credit or a deduction.[15] To qualify for "section 6015(b)" relief from both the IRS and the FTB, he or she must timely file Form 8857 with the IRS, and FTB Form 705 with the FTB, no later than two years after the date that the relevant agency began collection activities against the innocent spouse.[16] He or she must then establish that, when he or she signed the return in question, he or she

did not know, or had no reason to know, of his or her spouse's misstatement[17] **and** that, "taking into account all the facts and circumstances, it is inequitable to hold" him or her liable for the understatement of tax on that return.[18]

The second form of "innocent spouse" relief is available to those joint filers who are now divorced,[19] legally separated, or have not lived in the same household during the past 12 months.[20] As with section 6015(b) relief, an innocent spouse must elect section 6015(c) relief within two years of the IRS's commencement of collection activities against that individual.[21]

However, unlike section 6015(b) relief, section 6015(c) relief is limited to an allocation of each item "giving rise to a deficiency on a joint return . . . in the same manner as it would have been allocated if the individuals had filed separate returns for the taxable year."[22] Further, the IRS may limit this form of relief if the IRS "demonstrates that assets were transferred between individuals filing a joint return as part of a fraudulent scheme"[23] or "if the principal purpose of the transfer was the avoidance of tax or payment of tax."[24]

Consider the following example of how these first two forms of "innocent spouse" relief work, and don't work**:** On June 16, 2008, Cameron and Mitchell became one of the first same-sex couples to legally marry in California. In 2009, they timely filed joint state and federal income tax returns for 2008. Those returns included Schedules C reporting Mitchell's income, and other items, from his solo law practice. When the IRS audited their 2008 and 2009 returns, Mitchell told Cam: "Don't worry: I'll take care of it." Other than occasionally signing documents prepared by Mitchell, Cam heard nothing more about the audit until this week, when he opened a letter from the IRS and read that he owes $100,000+ on those returns. He calls you to discuss these matters. During that discussion, he tells you that he and Mitchell are still very happy together and want to stay married.

Unfortunately, even if all of the deficiencies assessed by the IRS are due to solely to Mitchell understating his Schedule C income, Cam cannot qualify for section 6015(b) innocent spouse relief **unless** he can show that he did not know, and had no reason to know, about those understatements when he signed their 2008 and later returns **and** that it would be unfair to hold him liable for Mitchell's understatements. Further, Cam does not qualify for section 6015(c) relief because he and Mitchell are still married and living together.

If a spouse does not qualify for either section 6015(b) or section 6015(c) relief, then the last innocent spouse refuge available is "equitable relief" under section 6015(f). To determine "when, considering all the facts and circumstances, it would be inequitable to hold the requesting spouse jointly and severally liable,"[25] the IRS will use, among others, the factors currently set forth in Revenue Procedure 2013-34.[26]

Among the factors that will weigh **in favor** of section 6015(f) equitable relief are whether the requesting spouse: is no longer married to the nonrequesting spouse;[27] would suffer economic hardship if relief is not granted;[28] had no knowledge or reason to know, as the date the return was filed, of the items giving rise to the deficiency or "that the nonrequesting spouse would not or could not pay the tax liability . . . within a reasonable period of time after the filing of the return,"[29] was abused by the nonrequesting spouse;[30] or "is in poor physical or mental health."[31] The factors weighing **against** equitable relief include that the requesting spouse: "has a legal obligation to pay the outstanding Federal tax liability [such as] a divorce decree or other legally binding agreement,"[32] "significantly benefitted from the unpaid income tax liability or understatement,"[33] and "has not made a good faith effort to comply with the income tax laws in the taxable years following the tax year or years" covered by his or her request for relief.[34]

The good news is that, unlike for the two-year statute of limitations for electing relief under section 6015(b) and (c), an innocent spouse can apply for section 6015(f) equitable relief at any time before the "collection statute of limitations"[35] expires or, if applicable, the expiry of the section 6511 period of limitation for credit or refund of overpaid taxes.[36]

Here is an example illustrating how section 6015(f) works**:** Wanda was married to Harry until his death in prison in 2011. During their marriage, he embezzled, without Wanda's involvement or knowledge, over $10,000,000 from investors in his Ponzi schemes. Harry spent most of that on gambling, drugs, and women, including Wanda. In 2009, after the money ran out, Harry pled "guilty" in return for a sentence of only 10 years. While Harry was in prison, the IRS and the FTB assessed over $5,000,000 in taxes, penalties and interest against him and Wanda for failing to report that embezzlement income on their joint tax returns. Wanda has been referred to you for innocent spouse relief.

Wanda should complete a Form 433-A to determine if she has any asset that would be lost in a bankruptcy. If she does, then file a completed Form 8857 and she may get partial equitable relief under section 6015(f). However, she would probably get relieved of her joint tax burdens more quickly, and less expensively, by filing for bankruptcy.[37]

Finally, in a California proceeding for dissolution of the marriage of a "husband and wife," California courts are authorized to "revise" their joint and several liability, for **California** income taxes owed on **California** joint returns, by court order.[38] However, such an order "may not relieve a spouse of tax liability on income earned by or subject to the exclusive management of the spouse."[39] Instead, a spouse's liability for the tax, penalties and interest for a tax year must be pro rata with the share of the couple's total income that is earned, or managed and controlled, by that spouse.[40] Further, the court order: must specify the spouses' separate income tax liabilities for specific tax years;[41] may only revise liabilities that are unpaid; [42] only becomes "effective when the Franchise Tax Board is served with or acknowledges receipt of the order;"[43] and is **not** effective "if the gross income reportable on the return exceeds [$150,000, or if either spouse's tax relief exceeds $7,500], unless a tax revision clearance certificate is obtained from the [FTB] and filed with the court."[44]

IV. Relief from Community Property Tax Liabilities

In general, a married taxpayer owns half of his or her spouse's earned income,[45] if that income is subject to

community property laws.[46] Earned income includes "wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered . . . ."[47] Earned income also includes "a reasonable allowance as compensation for the personal services rendered by the [taxpayer's spouse], not in excess of thirty percent of his share of the net profits of [a] trade or business" in which both personal and capital are material income-producing factors.[48]

Internal Revenue Code section 66(a) states that, if a taxpayer: is married at any time during a calendar year;[49] but the married couple "live[s] apart at all times during the calendar year;"[50] does not file a joint return with each other for that year;[51] **and** the taxpayer's spouse does not transfer any of his or her community income to the taxpayer during that year, then such income "shall be treated in accordance with the rules provided by section 879(a)."[52] One of the rules of section 879(a) is that: "Earned income (within the meaning of section 911(d)(2)) . . . shall be treated as the income of the spouse who rendered the personal services."[53]

As an example of section 66(a) relief, assume that, in 2010, Fred took a job in San Francisco, leaving Wilma and the children in their Pasadena home. They filed joint tax returns for 2010 and 2011. In August 2012, Wilma filed for divorce and her marriage was terminated in March 2014 so that Fred could remarry. Wilma filed her returns as a "head of household" in 2012 and 2013. Recently, the IRS began an audit of Wilma's 2012 and 2013 returns based on Fred's insistence that Wilma should pay tax on half of his earned income in those years. Under section 66(a), Wilma must pay federal income tax on half of Fred's earned income **until** they became estranged. Also, to qualify for the more favorable "head of household" tax rates, Wilma must prove, among other things,[54] that Fred was not a member of that household during the last six months of each tax year.[55]

If a taxpayer does not qualify for section 66(a) relief, then section 66(b) allows the IRS to grant relief if the taxpayer's spouse "acted as if [he or she were] solely entitled to [community earned] income and failed to notify the taxpayer … before the due date (including extensions) for filing the return for the taxable year in which the income was derived of the nature and amount of such income."[56] California tax law offers the same taxpayer the same relief on his or her California income tax return.[57]

To continue with the previous example: Assume that Wilma can show that the reason she filed for divorce was that Fred stopped sending her any of his earnings after November 2011 and never sent her a copy of either of his W-2s for 2012 or 2013. On the other hand, Fred did send their children Christmas and birthday gifts, some of which were cash, and sometimes sent her grocery money. Facts like those would support the argument that Fred acted as if he were solely entitled to his earned income as early as 2011 and that he and Wilma were estranged before 2012. Even the occasional gift of cash does not hurt, as the IRS has stated that *de minimis* transfers of earned income do not violate section 66.[58] Thus, Wilma can argue that she was justified in excluding all of Fred's 2012 earned income from her separate federal tax return for that year.

Even if a taxpayer does not qualify for relief under either section 66(a) or section 66(b), he or she will still receive relief from the income taxes resulting from the operation of community property laws if he or she did **not** file a joint return for the taxable years for which he or she seeks relief;[59] he or she included, in his or her gross income for such taxable years, an item of community income that, pursuant to section 879(a), would be treated as the income of the nonrequesting spouse;[60] the requesting spouse proves that he or she "did not know of, and had no reason to know of, such item of community income;"[61] under "all facts and circumstances, it would be inequitable to include such item of community income" in his or her gross income;[62] **and** he or she timely files a Form 8857 requesting such relief.[63]

If a spouse does not qualify for relief under section 66(a), section 66(b), or the traditional relief accorded by section 66(c), then equitable relief may still be available if "it is inequitable to hold the requesting spouse liable for the unpaid tax or deficiency (or any portion of either) . . . ."[64] The factors relevant to such relief are identical to the factors relevant to equitable relief for innocent spouses under section 6015(f).[65] On the other hand, the filing deadline differs; a Form 8857 requesting equitable relief under section 66(c) cannot be filed before "the requesting spouse receives notification of an audit or notice from the IRS stating that there may be an outstanding liability with regard to that year . . . ."[66]

V. Conclusion

This paper has examined fifteen forms of California and federal relief available to injured and innocent spouses. Please consult with a tax professional before applying for any of them. ■

---

* My thanks to Karl Swaidan, Hratch Karakatchian, and the attendees at the October 2014 meeting of the Pasadena Bar Association's Tax Section, for their comments on earlier drafts.

1 Joint returns are authorized by section 6013 of the Internal Revenue Code (hereinafter, "I.R.C."), which is title 26 of the United States Code ("U.S.C.")

2 *Cf.* I.R.C. § 1(a) *with* I.R.C. § 1(d); *see* Whittington, Leslie A., *Marriage Penalty*, http://www.urban.org/books/TTP/whittington.cfm (last visited July 3, 2014.).

3 I.R.C. § 6013(d)(3); CAL. REV. & TAX. CODE § 19006(b).

4 I.R.C. § 6402(a) ; Treas. Reg. § 301.6402-1; CAL. REV. & TAX. CODE § 19301(b).

5 I.R.C. § 6402(c); Treas. Reg. § 301.6402-5; 31 CFR §§285.1, 285.3 ; *contra* CAL. REV. & TAX. CODE § 19301 (California's Franchise Tax Board ("FTB") is not authorized to withhold an income tax overpayment because of such a debt).

6 I.R.C. § 6402(d); 31 U.S.C. § 3720A(a) ;(31 CFR §285.2; Treas. Reg. § 301.6402-6; c*ontra* CAL. REV. & TAX. CODE § 19301 (The FTB is not authorized to withhold an income tax overpayment because of such a debt).

7 I.R.C. § 6402(d)(3); 31 U.S.C. §§ 3720A(f)*; contra* CAL. REV. & TAX. CODE § 19301.

8 I.R.C. § 6402(e); 31 CFR §285.8; *see also* CAL. REV. & TAX. CODE § 19291(a) (allowing the FTB to collect and pay over

delinquent taxes owed to the IRS and to any state with a reciprocal agreement to collect taxes owed to the FTB).

9 I.R.C. § 6402(f)(1); *contra* CAL. REV. & TAX. CODE § 19301.

10 FTB, 705 booklet (rev'd 01-2011) at 2.

11 Hereinafter, the "IRS".

12 Thus, a taxpayer who has applied for **federal** innocent spouse relief may simply attach a copy of that application, *i.e.,* Form 8857, to his or her FTB application , *i.e.,* Form FTB 705, and then pursue only his or her federal application.

13 CAL. REV. & TAX. CODE § 19006*; see* http://ftb.ca.gov/individuals/faq/InnocentSpouse (last visited Oct. 15, 2014).

14 I.R.C. § 6015(b)(1)(A); CAL. REV. & TAX. CODE § 18533(a)(1)(A).

15 *See* I.R.C. § 6015(b)(1)(B); CAL. REV. & TAX. CODE § 18533(b)(1)(B).

16 I.R.C. § 6015(b)(1)(E); CAL. REV. & TAX. CODE § 18533(b)(1)(E).

17 I.R.C. § 6015(b)(1)(C); CAL. REV. & TAX. CODE § 18533(b)(1)(C).

18 I.R.C. § 6015(b)(1)(D); CAL. REV. & TAX. CODE § 18533(b)(1)(D).

19 I.R.C. § 6015(c)(3)(A)(i)(I); CAL. REV. & TAX. CODE § 18533(c)(3)(A)(i)(I). *NB*: A spouse's death is treated as a divorce. Treas. Reg. § 1.6015-3(a).

20 I.R.C. § 6015(c)(3)(A)(i)(II); CAL. REV. & TAX. CODE § 18533(c)(3)(A)(i)(II). *NB:* Where one spouse is in prison and the other spouse maintains a household in anticipation of his return, the spouses will be considered as members of the same household. Treas. Reg. § 1.6015-3(b)(3)(i).

21 I.R.C. § 6015(c)(3)(B); CAL. REV. & TAX. CODE § 18533(c)(3)(B).

22 I.R.C. § 6015(d)(3); CAL. REV. & TAX. CODE § 18533(d)(3). However, the disallowance of items of deduction or credit "solely because a separate return is filed . . . shall be disregarded and the items shall be computed as if a joint return had been filed and then allocated between the spouses appropriately." I.R.C. § 6015(d)(4); CAL. REV. & TAX. CODE § 18533(d)(4). Also, a child's tax liability "included on a joint return . . . shall be disregarded in computing the separate liability of either spouse and such liability shall be allocated appropriately between the spouses." I.R.C. § 6015(d)(5); CAL. REV. & TAX. CODE § 18533(d)(5).

23 I.R.C. § 6015(c)(3)(A)(ii); CAL. REV. & TAX. CODE § 18533(c)(3)(A)(ii).

24 I.R.C. § 6015(c)(4)(B)(i); CAL. REV. & TAX. CODE § 18533(c)(4)(B)(i).

25 Treas. Reg. § 1.6015-4(a).

26 Rev. Proc. 2013-34, 2013-43 I.R.B. (Oct. 21, 2013).

27 Rev. Proc. 2013-34, 2013-43 I.R.B. at 400, § 4.03(2)(a). "No longer married" means the requesting spouse is: under applicable state law, divorced, or legally separated from the nonrequesting spouse; "a widow or widower and is not an heir to the nonrequesting spouse's estate that would have sufficient assets to pay the tax liability;" or "has not been a member of the same household as the nonrequesting spouse at any time during the 12-month period ending on the date the Service makes its determination."

28 Rev. Proc. 2013-34, 2013-43 I.R.B. at 401, § 4.03(2)(b).

29 §§ 4.03(2)(c)(i)-(ii); *see* Rev. Proc. 2013-34, 2013-43 I.R.B. at 402, §4.03(c)(iii), for some of the factors that determine whether the requesting spouse had "reason to know" of the nonrequesting spouse's understatement, or underpayment, of tax.

30 Rev. Proc. 2013-34, 2013-43 I.R.B. at 402, § 4.03(2)(c)(iv).

31 Rev. Proc. 2013-34, 2013-43 I.R.B. at 403, § 4.03(2)(g).

32 § 4.03(2)(d).

33 § 4.03(2)(e).

34 § 4.03(2)(f).

35 I.R.C. § 6502; CAL. REV. & TAX. CODE § 19057.

36 Rev. Proc. 2013-34, 2013-43 I.R.B. at 399, § 4.01(3).

37 *See* 11 U.S.C. (the "Bankruptcy Code").

38 CAL. REV. & TAX CODE § 19006(b). Note that California courts do **not** have jurisdiction to revise a divorcing couple's liability for **federal** income taxes.

39 § 19006(b).

40 § 19006(b)(1).

41 § 19006(b)(2)(A).

42 § 19006(b)(2)(B)

43 § 19006(b)(2)(C).

44 § 19006(b)(2)(D).

45 I.R.C. § 66(d)(1) ("The term 'earned income' has the meaning given to such term by section 911(d)(2)").

46 § 66(d)(3) ("The term 'community property laws" means the community property laws of a state, a foreign country, or a possession of the United States.") The community property states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. I.R.S., Instructions For Form 8379 (rev'd Nov. 2012) at 1, col. 3.

47 I.R.C. § 911(d)(2)(A).

48 § 911(d)(2)(B).

49 § 66(a)(1).

50 § 66(a)(2)(A). "Living apart" means the spouses are estranged and maintaining separate residences. Treas. Reg. §§ 1.66-2(b), 1.6015-3(b)(3)(ii).

51 I.R.C. § 66(a)(2)(B). Thus, the standard tax attorney advice to divorcing spouses is: Do not sign a joint return.

52 § 66(a) (flush language). *Note bene:* California tax law does **not** offer section 66(a)-style relief.

53 § 879(a)(1).

54 *See* I.R.C. §§ 2(c), 7703.

55 *See* § 7703(b)(3).

56 § 66(b).

57 CAL. REV. & TAX CODE § 18534(b).

58 Treas. Reg. §§ 1.66-2(c), (d) ex. 2.

59 I.R.C. § 66(c)(1); CAL. REV. & TAX CODE § 18534(a)(1)).

60 I.R.C. § 66(c)(2); CAL. REV. & TAX CODE § 18534(a)(2) (which does not mention section 879(a).

61 I.R.C. § 66(c)(3); CAL. REV. & TAX CODE § 18534(a)(3).

62 I.R.C. § 66(c)(4); CAL. REV. & TAX CODE § 18534(a)(4).

63 Treas. Reg. § 1.66-4(j)(1). A Form 8857 requesting traditional relief may not be filed before "the requesting spouse receives notice of an audit or letter or notice from the IRS stating that there may be an outstanding liability with regard to" a separate return he or she filed. The latest such a request may be made "is 6 months before the expiration of limitations on assessments, including extensions, against the nonrequesting spouse for the taxable year that is the subject of the request unless the examination of the requesting spouse's return commences during that 6-month period." In the latter case, the Form 8857 must be filed within "30 days after the commencement of the examination." § 1.66-4(j)(2).

64 I.R.C. § 66(c) (last sentence of flush language); CAL. REV. & TAX CODE § 18534(a) (last paragraph).

65 *See supra* text accompanying notes 25-36.

66 Treas. Reg. § 1.66-4(j)(2)(ii).

Hot Off The Press!

Journal Edition

Dawn Gray, CFLS | Nevada County

dawn_gray@earthlink.net

Dawn Gray is a Past President of ACFLS. She is a solo practitioner whose practice is devoted to contract research and writing on family law issues. She is a frequent presenter on fiduciary duty and other issues throughout California.

Editor's Note:
The holdings from various cases are below. Dawn Gray's extensive summaries of those cases, too lengthy to publish in the Newsletter, are on the ACFLS website on the Current Newsletters page. The full text of her short summaries of other cases of interest is also provided below and on the website.

Andrew V. v. Superior Court, 234 Cal. App. 4th 103 (2015).

Holding: In this case, the Fourth District issued a writ of mandate compelling an Orange County trial court to vacate an order allowing W to "temporarily" relocate to Washington with the parties' two minor children pending a full evidentiary hearing on the relocation issue.

In re the Marriage of M.A. and M.A. et al., decided by the Fourth District on February 24, 2015.

Holding: In this case, the Fourth District reversed the orders of a court commissioner made after she failed to act on a party's statement of disqualification. It held that her failure to rule on the statement resulted in her being deemed to have consented to the disqualification, rendering her subsequent orders void.

Other Cases of Interest:

Becker v. Mays-Williams, No. 13-350069 (9th Cir. Jan. 28, 2015): In an ERISA interpleader action, the Ninth Circuit reversed an order of the U.S. District Court for the Western District of Washington. It held that a written beneficiary designation form was not a "plan document" and that nothing in the plan documents prohibited an unmarried employee from giving telephonic instructions to change his or her beneficiary fits. Therefore, the Plan was required to honor H's post-disso telephonic instructions to change his beneficiary from W to his son and could not refuse to honor the request because he failed to confirm it by signing the written beneficiary designation form before he died.

Aghaian v. Minassian, No. B252326, 2015 WL 661169 (Cal. Ct. App., Feb. 17, 2015): In this case, the Second District reversed a trial court's grant of a motion to stay a civil case under forum non conveniens. The trial court held that Iran was a suitable forum; in reversing, the panel held that there was insufficient evidence that Iran would be a suitable forum, because (n)otably absent is any indication that plaintiffs could receive a fair trial. Instead, the evidence is overwhelming that Iranian courts discriminate against women and non-Muslims. Among other things, plaintiffs submitted evidence that the testimony of a woman counts for half the value of that of a man, and that women are not treated equally before the courts, particularly in personal status matters relating to marriage, divorce, inheritance, and child custody, and only men can serve as judicial officers.

Both Clawson and Kar confirm that the judiciary in Iran is heavily influenced by religious authorities and that the law requires the head of the judiciary as well as the prosecutor general and all Supreme Court judges to be high ranking clerics. Clawson cites to "many accounts of unequal treatment afforded to non-Muslims by Iranian courts" as a basis for his opinion that the Iranian legal system discriminates on the grounds of sex, religion, and political opinion. Athari's declaration admits that Iranian law must not be in direct conflict with Islamic tenets. Two of the three plaintiffs here are women and the Galstian family members are not Muslim.

Leaving aside whether Iranian courts are independent or corrupt, this is sufficient to show Iran is not a suitable alternative forum. This is the "rare circumstance" in which an alternative forum "provides no remedy at all."

Ocegueda v. Perreira, 232 Cal. App. 4th 1079, 181 Cal. Rptr. 3d 845 (2015): In this case, the Third District reversed a Yolo County trial court. In what it calls a case of first impression, "we are asked to decide whether California is the home state of a child who was born in Hawaii, remained in Hawaii

for six weeks with his mother, then traveled to California with his mother, where, within 24 hours of his arrival, custody proceedings were commenced by his father in a California court." The panel said:

> The trial court determined that mother, who lived and was employed in California prior to the child's birth, went to Hawaii to give birth but intended to return to California. The court thus concluded that mother and the child "lived" in California, and their time in Hawaii was merely a temporary absence from California.
>
> We disagree. We conclude the child lived in Hawaii by virtue of the child's presence in Hawaii for the six weeks following his birth, leaving the state and traveling to California only 24 hours before father initiated these proceedings. We further conclude this fleeting presence in California prior to commencement of these proceedings does not alter the conclusion the child lived in Hawaii.
>
> Because the child was born in Hawaii and lived in Hawaii with his mother following his birth, Hawaii is the child's home state.

R.M. v. T.A., 233 Cal. App. 4th 760, 182 Cal. Rptr. 3d 836 (2015): In this case, the Fourth District affirmed a trial court's order finding that R.M. is Child's presumed father. T.A. conceived Child through artificial insemination, and R.M. is not Child's biological father.

The trial court declared R.M. to be Child's presumed father by applying the parentage presumption set forth in Family Code section 7611, subdivision (d) (hereafter, section 7611(d)).

> This statutory provision creates a presumption that a person is the natural parent of a child if the person shows by a preponderance of the evidence that he or she received the child into his or her home and openly held the child out as his or her own child.
>
> Mother claims she chose to be a single parent of Child and raises numerous constitutional and other legal challenges to the manner in which the presumed parent statutory scheme was applied in her case. Based on the fundamental constitutional right to parent one's child without interference, she requests that we establish a rule that a decision to form a single parent family should be afforded the same constitutional protection as a two parent familial arrangement. She also asserts the standards associated with the presumed parent statute do not adequately protect the constitutional rights of a single parent 'by choice.'
>
> We hold that application of the presumed parent statutory scheme in this case did not constitute an unconstitutional interference with Mother's fundamental right to parent her child. We conclude (1) the section 7611(d) parentage presumption serves the legitimate state interest in providing stability for children who have a parental relationship with the person afforded presumed parent status; (2) because the statutorily-prescribed requirements for the presumption necessitate a fully-developed parental relationship between the person and the child, the statute ensures that application of the presumption will not deprive a parent of his or her right to raise a child without interference by a nonparental figure; and (3) there is no basis for us to alter the long-established standards that govern the presumed parent statutory scheme.

Rodriguez v. Brill, No. F068518, 2015 WL 737383 (Cal. Ct. App., Feb. 20, 2015): In this Marvin action, the Fifth District reversed a trial court's order denying W's motion for relief from a default entered based on terminating sanctions for her failure to timely respond to a discovery demand. It held that the mandatory relief provided by section 473(b) upon an attorney's declaration of fault is available when a judgment of dismissal is entered as a terminating sanction for discovery abuse. It also held that "section 473(b)'s requirement that the 'application for relief' be 'in proper form' means verified discovery responses must be served with a motion for mandatory relief from a terminating sanction when that sanction was based on the failure to respond to discovery." It said that:

> [A]n attorney's application for mandatory relief would be in proper form if verified discovery responses are served on or before the motion for relief is served. Such service would demonstrate a willingness and ability to comply with discovery requests and related orders and demonstrate that pending discovery would not be a source of further delay. However, like the court in *Carmel, Ltd. v. Tavoussi, supra,* 175 Cal.App.4th 393, we conclude the phrase 'in proper form' is satisfied by substantial compliance. (Id. at pp. 401-403 [defendants substantially complied with requirement to submit a proposed answer with motion by making a copy available at the hearing].) A test for substantial compliance is whether the moving party has demonstrated a willingness and ability to comply with the procedural requirements that led to the dismissal.

In the context of a terminating sanction for failing to provide discovery, we conclude substantial compliance is demonstrated if, at or before the hearing on the motion for relief, the moving party has served a copy of verified discovery responses on opposing counsel. Service of final discovery responses indicates the moving party's readiness to proceed on the merits.

Blumberg v. Minthorne, 183 Cal. Rptr. 3d 179 (2015): In this case, the Fourth District applied the disentitlement doctrine and dismissed D's appeal from the trial court's orders after a bench trial in a civil case involving the administration of a trust, citing D's flagrant violation of the trial court's orders. It said that:

> Gloria's conduct since the judgment has frustrated the attempts of the court to legitimately effect its own orders. She has missed court dates, failed to keep her own promises, lacked candor in her communications with the court, and ignored the court's orders. She cannot therefore now seek relief from the appellate court. The disentitlement doctrine applies. ■

2015 ACFLS BOARD OF DIRECTORS

President
Jill L. Barr
Hemmer & Barr, Attorneys at Law
555 University Avenue, Suite 125
(916) 922-8500
jill@hemmerbarrlaw.com

Vice-President
Seth D. Kramer
4223 Glencoe Avenue, Suite A215
Marina Del Rey, CA 90292
(310) 474-3030
sdkramer2@aol.com

Treasurer
Karen C. Freitas
Parker, Milliken, Clark, O'Hara and Samuelian
555 South Flower Street, 30th Floor
Los Angeles, CA 90071
(213) 683-6503
kfreitas@pmcos.com

Secretary
John D. Hodson
Hodson & Mullin, Attorneys at Law
601 Buck Avenue
Vacaville, CA 95688
(707) 452-9606
hodsonesq@aol.com

Immediate Past President
Lynette Berg Robe
Law and Mediation Offices of Lynette Berg Robe
12711 Ventura Blvd., Suite 315
Studio City, CA 91604
(818) 980-9964
portia1000@aol.com

Journal Editor
Debra S. Frank
Debra S. Frank, APLC
1875 Century Park East, Suite 700
Los Angeles, CA 90067
(310) 277-5121
dfrank@debrafranklaw.com

Associate Journal Editor
Christine Gille
Goldberg & Gille
131 North El Molino Avenue, Suite 310
Pasadena, CA 91101
(626) 584-6700
cdgille@mac.com

Legislative Director
Dianne Fetzer
Law Office of Dianne M. Fetzer
455 University Avenue, Suite 201
Sacramento, CA 95825
(916) 565-1200
dfetzer@fetzerlaw.com

Associate Legislative Director
Michele Brown
Procopio, Cory, Hargreaves & Savitch, LLP
525 B Street, Suite 2200
San Diego, CA 92101
(619) 906-5745
michele.brown@procopio.com

Technology Director
Mark Ressa
5000 Executive Parkway, Suite 305
San Ramon, CA 94583
(925) 328-0103
mark@bayareadivorce.com

Associate Technology Director
Erin Levine
Levine Law Group, LLP
5801 Christie Avenue, Suite 387
Emeryville, CA 94608
(510) 595-4112
erin@levinefamilylawgroup.com

Education Director
Sherry Peterson
Law Office of Sherry Peterson
7950 Dublin Blvd., Suite 203
Dublin, CA 94568
(925) 833-6990
sherry@famlaw.com

Membership and Benefits Director
Paul L. Brimberry
Water Tower Plaza
2100 Northrop Avenue, Suite 100
Sacramento, CA 95825
(916) 568-8272
paul@familylawsacramento.com

Outreach Director
Linda L. Seinturier
1308 Placer Street
Redding, CA 96001
(530) 243-0253
l4linda@aol.com

Chapter Director (1)
David M. Lederman
Law Offices of David M. Lederman
3432 Hillcrest Avenue, Suite 100
Antioch, CA 94531
(925) 522-8889
david@ledermanlaw.net

Associate Chapter Director (1)
Anne Davies
Blum, Gibbs & Davies, LLP
1939 Harrison Street, Suite 818
Oakland, CA 94612
(510) 465-3927
anne@bgdfamilylaw.com

Chapter Director (2)
Fredrick S. (Rick) Cohen
Law Offices of Fredrick S. Cohen
2020 Hurley Way, Suite 200
Sacramento, CA 95825
(916) 925-7177
rick.cohen@familylawlitigators.com

Associate Chapter Director (2)
Stephanie L. Williams
Law Office of Stephanie L. Williams
1722 Professional Drive
Sacramento, CA 95825
(916) 927-8112
stephanie@divorceoptions.net

Chapter Director (3)
Dorie A. Rogers
Law Offices of Dorie A. Rogers, APC
790 The City Drive South, Suite 120
Orange, CA 92868
(714) 740-1160
drogers@drfamilylaw.com

Associate Chapter Director (3)
Jason M. Schwartz
Stegmeier, Gelbart, Schwartz & Benavente, LLP
20320 SW Birch Street, 3rd Floor
Newport Beach, CA 92660
(949) 337-4050
jschwartz@sgsblaw.com

Regional Director
Patricia A. Rigdon
Law Offices of Patricia A. Rigdon
301 East Colorado Blvd., Suite 706
Pasadena, CA 91101
(626) 405-0006
par@pasadenalaw.la

Coordinating Director (1)
Joseph J. Bell
Law Office of Joseph J. Bell
350 Crown Point Circle, Suite 250
Grass Valley, CA 95945
(530) 272-7477 or (800) 576-7477
attorney@bellslaw.com

Coordinating Director (2)
Sterling E. Myers
Helms & Myers
150 North Santa Anita Avenue, Suite 685
Arcadia, CA, 91006
(626) 445-1177
stermyers@aol.com

Coordinating Director (3)
Diane Wasznicky
Bartholomew & Wasznicky LLP
4740 Folsom Blvd.
Sacramento, CA 95819
(916) 455-5200
diane@divorcewithrespect.com

ACFLS JOURNAL

Dee Rolewicz, ACFLS Executive Director
1500 W. El Camino Avenue, Suite 158
Sacramento, CA 95833-1945

ACFLS
CLE on DVD/CD/MP3

Here are the recent Spring Seminars and 2015 programs available on DVD/CD/MP3. Browse the Educational Library Catalog at the online store at www.acfls.org. Over 125 advanced family law programs available.

- If you are an ACFLS member, don't forget to **sign in** before ordering, for member pricing.
- If you are a California Family Law Certified Specialist, and not yet an ACFLS member, **you should be!**
- ACFLS is a State Bar of California–approved MCLE provider and an approved family law provider by the State Bar of California Board of Legal Specialization: Provider #118.

CLE PROGRAMS ON DVD

NEW FOR 2015:
Joinder in Non Pension Cases – *Glenn P. Oleon, Comm Ret. (2/14/15)*

2014 RELEASES:
From 'I Rest' to 'I Appeal' – The Post-Evidentiary Phase of a Trial – *Leslie Ellen Shear, CFLS, CALS, IAML (1/28/14)*

Strategies and Presentation of Date of Separation Trials – *Hon. Alice Vilardi (2/11/14)*

Spousal Support – 4320 Factors: What Effect Does it Really Have on the Ruling and the Interplay with Marital Standard of Living and Incomes – *Hon. Michael S. Ullman (Ret.); Hon. Thomas M. Cecil (Ret.) (3/25/14)*

Move-Aways: The Law Has Changed, Or Has It? – *Charlotte Kelley, Esq. (4/22/14)*

Spousal Support: Presenting the Spousal Support Claim at Trial – *Hon. Glenn Oleon; Sherry Peterson, CFLS (5/27/14)*

Power PreNups – *Christopher C. Melcher, CFLS (6/10/14)*

Goodwill Hunting: The Never-Ending Debate (2014) – *Edward Thomas, CFLS (8/26/14)*

Advocacy in Action: The Psychology of Persuasion – *Ronald S. Granberg, CFLS (9/23/14)*

Substance Abuse Issues in Custody Litigation – *Nathan E. Lavid, M.D.; Jason M. Schwartz, CFLS (11/17/14)*

RECENT SPRING SEMINARS

22nd Annual Spring Seminar
3/21/2014 – 3/23/2014
"Truth or Consequences… The Intricacies of Fiduciary Duties"

Why I Love Fiduciary Duties and Why You Should Love Them, Too – *Dawn Gray, CFLS*

Managing Your Own Client's Compliance with Fiduciary Obligations – *Stephen J. Wagner, CFLS; Edward J. Thomas, CFLS*

Here, There, But Not Everywhere: Unique Problems Involving Fiduciary Duties – *Stephen Temko, CALS, CFLS; Sandra Joan Morris, CFLS*

How Do You Induce the Opposing Party to Comply? – *Sharon L. Kalemkiarian, CFLS; Sharon A. Blanchet, CFLS*

Balancing Business Interests and Fiduciary Duties – *Peter M. Walzer, CFLS; Hon. Mark A. Juhas*

Litigating a Fiduciary Duty Claim – *Stephen J. Wagner, CFLS; Robert E. Blevans, CFLS*

Ask the Judges – the Last Word on "The Intricacies of Fiduciary Duties" – *Hon. Dianna Gould-Saltman; Hon. Thomas Trent Lewis; Hon. Robert A. Schnider (Ret.); Hon. Marjorie A. Slabach (Ret.); Moderator: Garrett C. Dailey, CFLS*

23rd Annual Spring Seminar
3/20/2015 – 3/22/2015
"Submitted: Mastering Rulings, Orders & Judgments"

Orders and Judgments: The Lawyer's Role – *Robert C. Brandt, CFLS, Ronald S. Granberg, CFLS, and John D. Hodson, CFLS*

How to Avoid Embarrassment When Making Pendente Lite Requests – *Hon. John Chemeleski and Hon. Alice Vilardi*

Statements of Decision: The Appellate Point of View – *Justice Dennis Cornell*

Judgments and Marital Settlement Agreements: It All Comes Down to This – *Hon. Erick Larsh, Barbara K. Hammers, CFLS, and Sherry Peterson, CFLS*

Orders Across Borders – *Leslie Ellen Shear, CALS, CFLS, IAML, and California Deputy A.G. Elaine F. Tumonis*

Thoughtful Challenges to Adverse Rulings, Orders and Judgments in the Trial Court – *Stephen Temko, CALS, CFLS, and Hon. Patti Ratekin*