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Los Angeles Lawyer

June 2010 /$4

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by Howard S. Klein

PARTING OF THE WAYS

Clients contemplating divorce need to consider revision of their estate plans

FAMILY LAW attorneys are well versed in divorce, and estate planning practitioners in death, but too often, family law attorneys do not give adequate consideration to estate plans before, during, or after filing for dissolution. Similarly, estate planning practitioners may not contemplate the consequences of a marital dissolution on the estate plans of clients. Attorneys of both specialties must prepare for the intersection of family law and estate planning. Estate planners need to inform their clients that dissolution of marriage often renders a previously prepared estate plan ineffective and the marital assets subject to the laws of intestate succession. Likewise, family lawyers need to recognize that protection of a divorcing client's property involves ensuring that the client's estate planning needs are met before, during, and after the dissolution.

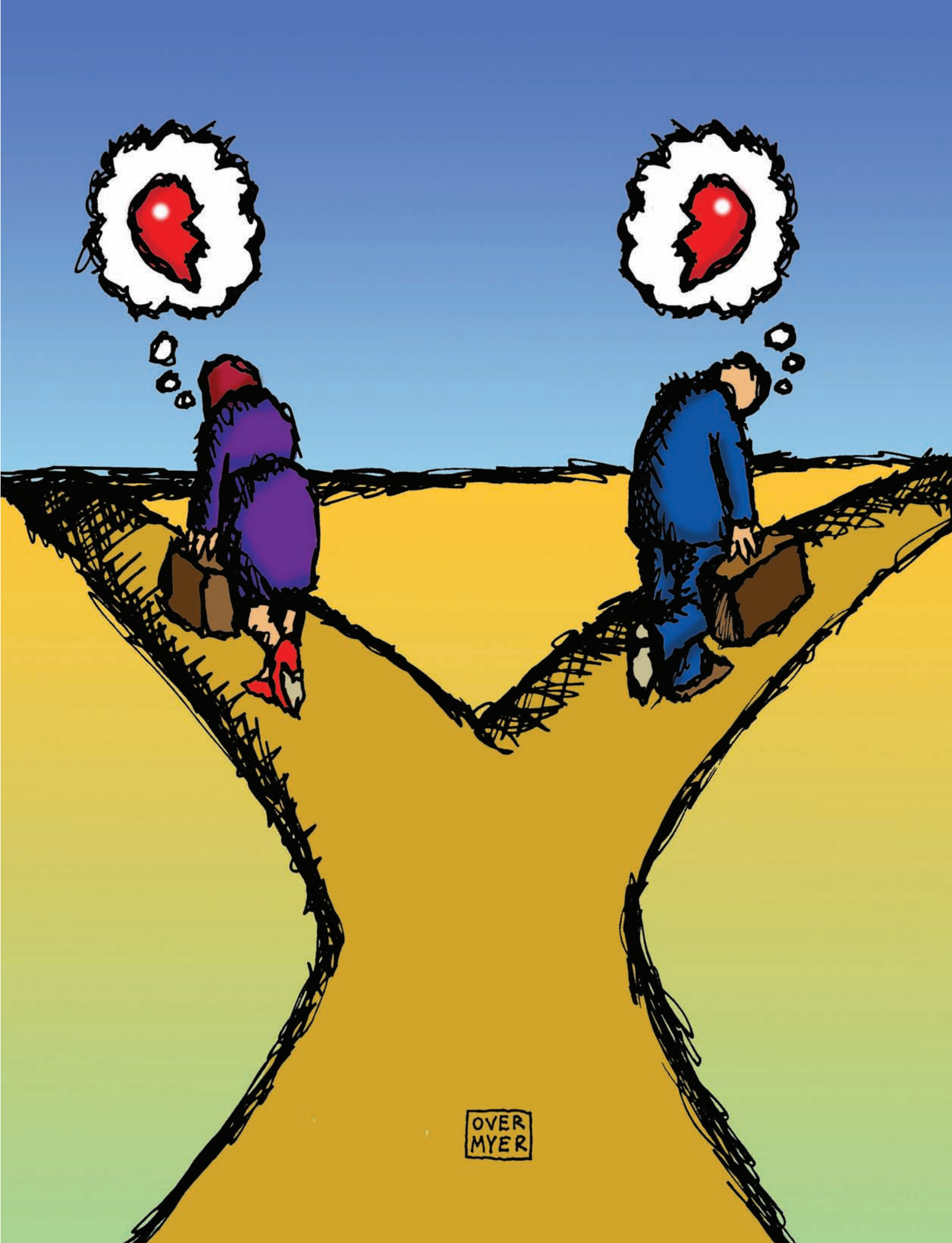
Marriage or a registered domestic partnership imposes fiduciary duties on the partners. A spouse or domestic partner who is looking to protect his or her assets prior to dissolution is in an unusual position. While the constraints of the standard (or automatic) temporary restraining orders are not applicable until dissolution is initiated, his or her actions are subject to the interspousal fiduciary duties described under Family Code Section 721.[1] Thus, asset protection and estate planning in the predissolution stage must adhere to the rules governing fiduciary relationships.

The interspousal fiduciary duties imposed under Family Code Section 721 provide that, in transactions with each other, a husband and wife are subject to the general rules governing fiduciary relationships that control the actions of a person in a confidential relationship. This relationship imposes a duty of the highest good faith and fair dealing, and neither spouse may take unfair advantage of the other. Further, the law obliges spouses to make full and fair disclosure of financial information to each other. These standards must be adhered to when evaluating changes to the character of marital property.

For example, estate planners may transfer or recharacterize property though a transmutation, as described by Family Code Section 850 et seq. A transmutation often drafted by estate planners involves changing one spouse's separate property to community property in order to achieve an increase in basis of real property upon the death of either spouse[2] or to equalize the estate between husband and wife. Although this transfer offers advantages in estate planning, it presents a significant disadvantage in divorce to the spouse who gave away half of his or her

Howard S. Klein, a certified specialist in estate planning, trust, and probate law, heads the Probate Department at Feinberg, Mindel, Brandt & Klein, LLP in West Los Angeles, where he specializes in probate and family law crossover matters. The author acknowledges the contributions of his associate, Taylor Bouchard.

RON OVERMYER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separate property.

In addition, when only one spouse benefits from an interspousal transaction, the law presumes that the transaction was the product of undue influence. Once that presumption arises, the advantaged party has the burden to prove that the disadvantaged party was not unduly influenced. *In re Marriage of Delaney*[3] sets forth the elements that the advantaged spouse must establish to prove that no undue influence was used in a transmutation. First, the transmutation must have been freely and voluntarily made by the disadvantaged spouse. Second, the disadvantaged spouse must have had full knowledge of all the facts. Third, the disadvantaged spouse must have had a complete understanding of the effect of the transmutation. These rigorous standards of fiduciary duty and undue influence leave little room for dishonesty in estate planning before a divorce. Once clients who are planning divorce have been advised of their fiduciary obligations as spouses, however, they may still benefit from a review of their estate plans with an eye not toward death but divorce, as the example of transmutation to community property shows.

The end of community property acquisitions is marked by the date of separation, as provided for under Family Code Section 771. Separation allows for the accumulation of separate property but does not terminate the duty of highest good faith and fair dealing owed to one's spouse. This critical date is determined by the intent of one spouse to end the marriage, coupled with the objective conduct of furthering that intent.[4] In Family Code Section 2100(a), the California Legislature has promulgated its policy to "marshal, preserve, and protect community and quasi-community assets and liabilities that exist at the date of separation so as to avoid dissipation of the community estate before distribution." In line with this policy, Family Code Section 2102(a) expressly extends a spouse's fiduciary duties from the date of separation to the date of distribution. An estate planner must recognize that, while the date of separation triggers the end of the accumulation of community property assets, it does not end a spouse's fiduciary duties with regard to all marital assets of whatever character.

An estate planner may consider several means of protecting the character of a spouse's property while maintaining compliance with a spouse's fiduciary duties:

• **A temporary or conditional will.** This instrument is almost always a sound idea, whether to change the existing will or, on the other hand, to republish the existing will in light of Probate Code Section 6122(a), which revokes existing wills on dissolution unless the will expressly provides otherwise.

• **Postnuptial agreement.** A postnuptial agreement is essentially a different label for a transmutation agreement and must therefore comply with the applicable statutes and cases. A severability clause may be an important provision in this type of agreement, so that the entire agreement is not void in the event that a particular provision is deemed invalid.

• **Creation of a separate property trust.** This trust will enable the settlor of the trust to maintain the separate property character of certain assets free from the common pitfalls of commingling or enhancement with community property funds.

During Divorce Proceedings

Whether or not new instruments are necessary or appropriate, an estate planner will need to deal with standard (or automatic) temporary restraining orders. Commonly known as ATROs, they bind the petitioner upon filing the petition for dissolution and issuance of summons, and the respondent upon service.[5] For estate planners, the critical ATRO provisions are those that preclude any transfer, encumbrance, or disposal of community or separate property without the written consent of the other party or order of court, except in the usual course of business or for necessities of life.

Standard provisions also preclude cashing, borrowing against, canceling, transferring, or changing the beneficiaries of any insurance policy or other coverage. In addition, they preclude creating a nonprobate transfer or modifying a nonprobate transfer in a manner that affects the disposition of property subject to the transfer without the written consent of the other party or order of the court. "Nonprobate transfer" is defined by Family Code Section 2040(d)(1) as an instrument other than a will that transfers property on death, including revocable living trusts, payable on death accounts, Totten trusts, and similar items.

Pursuant to Family Code Section 233, these restraining orders remain in effect until final judgment of dissolution is entered. A spouse who violates one of the ATROs is in contempt of court, and the aggrieved spouse is entitled to restitution in the amount that would have been realized had the asset been available at the finalization of dissolution.[6]

Notwithstanding the ATROs, Family Code Section 2040(b) expressly reserves the right of a spouse to make certain estate planning changes during dissolution proceedings, providing these exemptions from the ATROs: 1) creation, modification, or revocation of a will, 2) revocation of a nonprobate transfer, most notably a revocable living trust pursuant to the trust instrument, provided that notice of the change is filed and served on the other party before the change takes effect (see "Revocation of a Family Trust without the Knowledge of the Cotrustee" by Kira Masteller, page 16), 3) elimination of a right of survivorship to property, typically by severing joint tenancy, provided that notice of the change is filed and served before the change takes effect, 4) creation of an unfunded revocable or irrevocable trust, and 5) execution and filing of a disclaimer.

Pursuant to Section 2040(b)(2), a client may revoke a nonprobate transfer so long as it does not affect the disposition of property. Otherwise, the revocation would violate the ATROs. An example of an estate planning tool that successfully avoids violation of Family Code Section 2040(a)(4)—which prohibits nonprobate transfers that affect the disposition of property, and at the same time, is within the exemption of Family Code Section 2040(b)(2)—is naming a new trustee or successor trustee. In *Estate of Khan*,[7] the court found the husband's attempt to revoke a trust while engaged in dissolution litigation represented an attempt by him to transmute community property into separate property in violation of an existing restraining order. Specifically, the court held that because the trust was created jointly, the husband acting alone could not revoke it. Normally, under Family Code Section 2040(b), a spouse may revoke such an instrument, but if the revocation clauses of the trust agreement utilize language in the plural (e.g., "us"), the agreement is controlling, and both spouses must mutually agree to the revocation. In contrast, a spouse may not change the beneficiary of a nonprobate transfer because that would affect the disposition of property and violate the ATROs.

Subsection 2040(3) allows a party to a dissolution action to eliminate a right of survivorship to property. This subdivision was the product of a 2001 amendment that sought to make the section consistent with the holding in *Estate of Mitchell*.[8] In *Mitchell*, a husband and wife held property as joint tenants. When the couple initiated dissolution proceedings, the husband recorded declarations of severance pursuant to Civil Code Section 683.2(a)(2) in order to terminate the joint tenancy and end the right of survivorship. About a month later, while the dissolution proceeding was still pending, the husband died. The court held that "when one spouse severs a joint tenancy with the other spouse by executing and recording a declaration of severance, there is neither a transfer nor a disposition of any property. Such a severance therefore does not violate an injunctive order entered pursuant to Family Code Section 2040."[9] The code section allows for such a severance with the added requirement that notice of the change is filed and served on the other party before the change takes effect.

The case of *Allstate Life Insurance v. Dall*[10] is an example of the interplay between the ATROs and the estate planning changes expressly permitted pendente lite. In *Allstate,* a husband purchased a life insurance policy during the marriage naming his wife as the primary beneficiary and his sons as equal contingent beneficiaries. Several years later, the wife filed for dissolution, and the filing subjected the parties to the ATROs. On February 21, 2007, the husband and wife signed a marital settlement agreement, with each spouse waiving respective rights as beneficiaries to life insurance policies. The judgment was not entered until April 20. Before entry of final judgment, Allstate Insurance received husband's request for a beneficiary change. On July 5, the husband died. The court found that the ATROs remained in effect until April 20, when the trial court issued its final order. Because the husband was enjoined from submitting a change of beneficiary form until after April 20, the April 4 request had no legal effect. However, since the wife disclaimed her interest under the marital settlement agreement, as permitted by Family Code Section 2040(b)(5), the sons, as equal contingent beneficiaries, became the sole beneficiaries of the life insurance policy. So, although the husband was unable to change the beneficiary designation when he did because of the ATROs, the execution of the marital settlement agreement exercised one of the exempt estate planning changes, thereby effectuating the change in beneficiary.

Together, the standard ATROs and the permissible actions listed under Family Code Section 2040(b) offer guidance when representing a client who is in dissolution proceedings. Possible steps to take include a new will that revokes the former will and designates a different executor and new beneficiaries. Although the final judgment will revoke the former spouse's share of the decedent's estate, this automatic revocation does not take place until the entry of the judgment. So, as a precaution, an estate planner should advise the client to revoke his or her will as early as the filing of the petition.

Additional steps to take include revoking an existing living trust (after providing the requisite notice) and then returning the revoked trust's assets to the parties; severing any joint tenancies (after providing the requisite notice) so that the parties hold the subject property as tenants in common, with each party having testamentary power over his or her half share; and terminating payable-on-death accounts (after providing the requisite notice) so that the surviving spouse is not the beneficiary of the accounts in the event of the other spouse's death during dissolution proceedings.

Another option is to create an unfunded trust that serves as a receptacle for property, subject to a pour-over provision in a newly drafted will.[11] The unfunded trust and the pour-over do not violate the ATROs. However, if the client dies during the proceedings, his or her will adds to the new trust all assets belonging to the client that were formerly in the revoked trust, together with the client's share of the joint tenancy, payable-on-death accounts, and similar assets over which he or she acquired the right of testamentary disposition. While these assets would have to be administered in the decedent's probate estate, at least they would pass to the client's desired beneficiaries and would be under the stewardship of the client's desired fiduciaries.

The family court is likely to scrutinize these transactions for compliance with the fiduciary duties of Family Code Section 721. But they are permissible within the language of Family Code Section 2040. They do not affect the status quo of the marital assets during the pendency of the family court proceedings.[12] As a protective measure, an attorney may seek a court order. This is a viable option under Family Code Section 2040(a)(2). If certain estate planning devices cannot be implemented until final judgment is entered and the risk of death before final judgment is high, court intervention is appropriate. ATROs are boilerplate, one-size-fits-all orders, so they may be appropriate for modification when the unique circumstances of a family so demand. A court has the inherent power to modify an injunction when "the ends of justice would be served by modification."[13]

After the Dissolution

The entry of a marital dissolution judgment automatically revokes all testamentary distributions to, and appointments of, the former spouse. This automatic revocation may well create an intestacy, and at the very least it will leave large holes in the estate plan of the newly divorced spouse. Typically, the purpose of the previously created estate plan is frustrated or rendered ineffective as a result of a divorce. The automatic revocation of certain testamentary distributions is effectuated through Probate Code Sections 6122[14] and 5600.

As to estate plans involving a transfer other than by will, Probate Code Section 5600(a) provides that "a nonprobate transfer to the transferor's former spouse, in an instrument executed by the transferor before or during the marriage, fails, if, at the time of the transferor's death, the former spouse is not the transferor's surviving spouse…as a result of the dissolution or annulment of the marriage…."

The exceptions to Section 5600(a)'s causing of a nonprobate transfer to fail are any of the following: 1) the nonprobate transfer is

not subject to revocation by the transferor at the time of the transferor's death, 2) there is clear and convincing evidence that the transferor intended to preserve the nonprobate transfer to the former spouse, or 3) a court order that the nonprobate transfer be maintained on behalf of the former spouse is in effect at the time of the transferor's death.[15]

Although a client may feel secure in his or her knowledge that the judgment for dissolution will operate to ensure that the former spouse receives nothing from the estate, the judgment simultaneously functions to create gaps in an estate plan, possibly defeating the efficiency of the plan and even resulting in an intestacy. A client should not rely solely upon the statutory revocations and should instead work with an estate planner to revise all beneficiary designations in order to ensure that the client's estate plan will meet current needs.

Estate planning attorneys should advise a newly divorced spouse to create appropriate estate planning documents, such as a new revocable living trust, pour-over will, trust transfer deeds, assignment of assets, power of attorney, and advance healthcare directive. When that is accomplished, the client will at least have provided for the most important persons in his or her life and will have a health directive in place.

If the client has a new spouse or domestic partner in the wings, a dissolution is also the time for the client to give serious consideration to the preparation of a premarital agreement, in order to preserve the separate character of his or her existing assets, to determine the character of new earnings, and to handle such matters as spousal support and succession to property on death. Also, it is important for the client to create a new will that sets forth the testator's intention to provide for (or not to provide for) his or her significant other.[16] While divorce is not as certain as death, preparing for the complexities surrounding the intersection of divorce, death, and disposition of property enable an estate plan to remain effective. ■

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[1] California law recognizes registered domestic partners as well as spouses. FAM. CODE §297.5(a). Similarly, the Probate Code has been amended to provide for domestic partners or domestic partnerships as a logical analog to statutes mentioning spouses and marriage. *See, e.g.,* PROB. CODE. §§6401, 6122.1.

[2] *See* I.R.C. §1014(b)(6).

[3] In re Marriage of Delaney, 111 Cal. App. 4th 624 (2003).

[4] Marriage of Hardin, 38 Cal. App. 4th 448, 451 (1995).

[5] *See* FAM. CODE §§2040(a), 231, and 233; Judicial Council Form FL-110.

[6] This restitution remedy is similar to the Family Code §1101(g) remedy for breach of a spouse's fiduciary duty. *See* Marriage of McTiernan & Dubrow, 133 Cal. App. 4th 1090 (2005) (A husband sold community property stocks pendente lite and used the proceeds to pay community debt. His wife was awarded 50% interest in lost profits.).

[7] Estate of Khan, 168 Cal. App. 3d 270 (1985).

[8] Estate of Mitchell, 76 Cal. App. 4th 1378 (1999).

[9] *Id.*

[10] Allstate Life Ins. v. Dall, 2009 U.S. Dist. LEXIS 100401 (E.D. Cal. Oct. 27, 2009).

[11] This technique is suggested in *Estate Planning During Marital Dissolution*, 30 CAL. L. REVISION COMM'N REPORTS 603 (2000).

[12] *See* Howard S. Klein, *Tales of Two Courts*, LOS ANGELES LAWYER, Apr. 2005, at 29.

[13] *See* CODE CIV. PROC. §533, *as cited in* Estate of Ronald D. Fuller, 2005 Unpublished LEXIS 3380 (1st Dist. Div. 1 Apr. 18, 2005).

[14] "Unless the will expressly provides otherwise, if after executing a will the testator's marriage is dissolved or annulled, the dissolution or annulment revokes all of the following: (1) any disposition or appointment of property made by the will of the former spouse; (2) any provision of the will conferring a general or special power of appointment on the former spouse; and (3) any provision of the will nominating the former spouse as executor, trustee, conservator or guardian." PROB. CODE §6122(a).

[15] PROB. CODE §5600(b).

[16] If a decedent should elect not to provide for his or her spouse in his or her will or living trust, Probate Code §21610 will provide for the omitted spouse in the decedent's estate unless one of three circumstances apply: 1) the failure to provide was intentional and that intention appears from the testamentary instruments, 2) the decedent provided for the spouse by transfer outside of the estate passing by the testamentary instruments, or 3) the spouse made a valid agreement waiving the right to share in the decedent's estate. PROB. CODE §21611.