

A Spouse Managing a Community Asset Doesn't have a Duty to Invest Prudently, but Does have a Duty to Disclose the Lack of Prudence Upon Request.

By Mitchell A. Jacobs and Valerie C. West*

Practitioners representing divorcing spouses whose community assets took a beating in the dramatic decline of stock values might want to carefully consider the scope of fiduciary spousal duties set out in the recent case of the *Marriage of Duffy*. The *Duffy* court held that spouses do not have a duty of care in investing community assets, only a lesser duty of "good faith", loosely defined as "honesty of intention," accompanied by a duty of disclosure on request. Said another way, spouses are immune from claims that community assets were squandered with foolish investments, as long as the spouse had "honesty of intention" and full information about investments, foolish or otherwise, was disclosed upon inquiry.

In *Duffy*, the parties separated in 1997 after 34 years of marriage. A trial the Wife was awarded damages based on Husband's claimed breach of the spousal fiduciary duty of disclosure regarding investment of community assets. Husband failed to inform his wife that he had invested his entire retirement brokerage account in one stock, which he bought and sold at different prices over a period of several years. Before separation the account had a peak value of \$611,648, but by the time of trial was worth only \$261,483.

During the marriage, Wife had participated in some

investments of community funds. As to others, she had inquired and received some information but was often given a curt response or a dismissive waive of the hand. As to the brokerage account in question, although Wife testified that she had never sought any information, she claimed that the lack of information upon inquiry about other issues permitted the inference that inquiry would have been futile, or that she had actually made inquiry without results. The trial court found that Husband had breached the fiduciary duty of disclosure to his spouse regarding the investment of the brokerage account and awarded the wife \$400,684 in damages.

The Court of Appeal reversed the damage award and held that Husband had not breached the fiduciary duty of disclosure because wife had not made the inquiry required by the statute. Using the same factual findings, the *Duffy* court also considered and rejected the alternate theory that Husband had breached a fiduciary duty of care that might have supported the damages award. *Duffy* emphatically held that spousal fiduciary duty does not include a duty of care.

Family Code section 1100(a) permits either spouse to manage and control community assets with the same power of disposition, other than testamentary, as the spouse has over separate property. Section 1100(e) provides that in the management and control of community assets each spouse is bound by "general rules governing fiduciary relationships which control the actions of persons having relationships of personal confidence as specified in Section 721,..." Subdivision (e) further

specifies that this duty "includes the obligation to make full disclosure to the other spouse of all material facts and information regarding the existence, characterization, and valuation of all assets in which the community has or may have an interest..., and to provide equal access to all information, records, and books that pertain to the value and character of those assets..., *upon request.*" (Italics added.)

Family Code section 721, on which section 1100 relies to define the scope of spousal fiduciary duty, defines the relationship of spouses to be a confidential one that imposes a "duty of the highest good faith and fair dealing" and that "neither shall take any unfair advantage of the other." It is a "fiduciary" relationship subject to the same rights and duties of nonmarital business partners as set forth in specified sections of the Corporations Code, including the following: "(1) Providing each spouse access at all times to any books kept regarding a transaction for the purposes of inspection and copying. (2) Rendering *upon request*, true and full information of all things affecting any transaction which concerns community property. (3) Accounting to the spouse and holding as a trustee, any benefit or profit derived from any transaction by one spouse without the consent of the other spouse which concerns community property."

As to the fiduciary duty of disclosure, the *Duffy* court held based on Wife's testimony that since she had never inquired about the brokerage account, there could be no breach of the disclosure duty. The court found completely unpersuasive Wife's

contentions that Husband's curt, dismissive, responses to requests for information justified an inference that Husband had ignored her requests about the brokerage account, or that it would have been futile for her to ask and therefore she was not required to do so. Thus in the absence of any inquiry, or facts that compel the inference that inquiry would have been futile, there can be no breach of the spousal fiduciary duty of disclosure.

Next, the court considered whether spousal fiduciary duty includes the duty of care, known also as the Prudent Investor Rule. While acknowledging that in some circumstances a fiduciary duty does include the duty of care in the management of property, the *Duffy* court again emphatically found that spouses are not bound by a duty of care in investing community assets.

This conclusion, as the court noted, required both statutory interpretation and historical review. Before 1975, only the Husband had the right to manage community property and in so doing owed a duty of loyalty to the Wife, but not a duty of care in the management of assets. At that time the desirability of freely transferrable personal property outweighed any harm suffered by the wife.

In 1975 amendments to former Civil Code sections 5125 and 5127 conferred equal management and control rights on the husband and wife, and changed the fiduciary duty to one of a duty of "good faith" which is a lesser duty than the duty of loyalty. (See *Marriage of Stevenot* (1984) 154 Cal. App. 3rd

1051, 1068, 1070) As explained in *Duffy*, the cases following the 1975 amendments were correct when they held that "good faith" and "fiduciary duty" are not coextensive. "Good faith" encompasses "honesty of intention" and an "absence of malice", whereas a fiduciary duty requires more. It requires loyalty, or a commitment to not secure any advantage, in opposition to the other party without that party's knowledgeable consent.

Dissatisfied with this interpretation of former Civil Code sections 5125 and 5127 (now Family Code sections 1100 and 1102), the legislature attempted to enact a higher standard, "a fiduciary duty", on the part of the spouse managing a community asset by amending section 5103 (now Family Code section 721). However, the bill passed by the legislature in 1989 establishing a "fiduciary duty" was vetoed by then-Governor George Deukmejian. In his veto message, the Governor acknowledged that while "the intent of the bill to clarify marital property management standards and protect both spouses regarding community property assets," was laudable, there was too great a likelihood that enactment of a "fiduciary duty" standard "will increase litigation and attendant costs of divorce proceedings" and "severely impact the doctrine of finality [of a judgment] by allowing either spouse, even many years later, to appeal to a court to set aside a judgment and marital settlement agreement, based upon a claimed breach of fiduciary duty."

Governor Deukmejian was concerned, "that, to the extent that an investment made during a marriage lost money and was one that a prudent fiduciary would not have made, this bill would

provide a forum to reopen virtually all of those transactions. Since spouses regularly make investments that fiduciaries would never make, and because the disillusionment and distrust engendered by marital breakup often leads individuals to expand litigation beyond reasonable limits obvious problems are created...."

In 1991, the legislature again tried to amend the statutes defining spousal duty and succeeded after several revisions to the language initially proposed. To arrive at its interpretation of what are now Family Code sections 721 and 1100(e), the *Duffy* court carefully examined the revisions to the bill.

The initial language proposed an amendment to former Civil Code section 5125, [now Family Code section 1100(e)] that "spouses shall act with respect to the other spouse in the management and control of the community property in accordance with the general rules governing fiduciary relationships which control the actions of persons as specified in Section 5103, until such time as the property has been divided by the parties or by a court.

The first revision was to amend former Civil Code section 5103 subdivision (b) (now Family Code section 721 (b)) to state that "[e]xcept as provided in Sections 143, 144, 146 and 16040 of the Probate Code,...a husband and wife are subject to the general rules governing fiduciary relationships....*This confidential relationship imposes a duty of the highest good faith and fair dealing on each spouse, and neither shall take*

any unfair advantage of the other. This confidential relationship is analogous to the fiduciary relationship of nonmarital business partners as provided in Sections 15019, 15020, 15021, and 15022 of the Corporations Code, including, but not limited to "certain enumerated rights. (Italics indicates proposed amendments.)

A final series of amendments specified that the confidential relationship is a fiduciary relationship, rather than simply being analogous to a fiduciary relationship between nonmarital business partners. The final version also specified that the relationship was subject to the same rights and duties of nonmarital partners, but eliminated the phrase "but not limited to" as a preface to the enumeration of the rights in the sections of the Corporations Code specifically mentioned.

The combined effect of the final revisions specifically eliminated the Prudent Investor Rule (then incorporated in Probate Code section 16040) from the spousal fiduciary duty and also restricted the rights and duties to those enumerated. The possibility that the duty of care could be implied was foreclosed.

Thus, spouses infuriated at their former mates' lack of prudence and foresight in market investments must look first to their own conduct. If a spouse unsuccessfully sought disclosure, damages may be a possibility. If a spouse failed to request disclosure, he or she will find no help in the spousal duty to disclose. Spouses who successfully obtained disclosure but failed to take action to change the investment strategy will

find no remedy in the spousal fiduciary duty.

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