

## Marital Settlements Are Subject To Fraudulent-Transfer Statute

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**T**he rights of creditors can conflict with the rights of a spouse in a divorce action to be free of the other spouse's debts. Resolving a split of authority, the California Supreme Court in *Mejia v. Reed*, 31 Cal.4th 657 (2003), addressed this issue.

The Supreme Court affirmed the Court of Appeal, holding that a creditor can set aside a transfer of property in a marital settlement agreement pursuant to the Uniform Fraudulent Transfer Act upon a proper showing of facts. The court disapproved *Gagan v. Gouyd*, 73 Cal.App.4th 835 (1999), to the extent that it held that the Uniform Fraudulent Transfer Act does not apply to marital settlement agreements.

The court also ruled that future child support should not be considered a "debt" in determining whether a party is insolvent at the time of the alleged fraudulent transfer. Insolvency is one of two requirements for proving construc-

the mother's failure to provide any direct evidence of an intent to defraud and the fact that the community property was equally divided between him and his former wife. He contended that the value of his medical practice at the date of separation was \$600,000.

The mother responded that the court could infer the intent to defraud from the circumstances. She presented expert opinion that the value of the husband's medical practice was \$100,000 and that the discounted present value of future child-support payments exceeded that amount.

The trial court assumed that the Uniform Fraudulent Transfer Act applied to a marital settlement agreement but granted the husband's motion because there was no evidence of actual intent to defraud and because the transfer did not render the husband insolvent.

The Court of Appeal agreed that the Uniform Fraudulent Transfer Act applied to marital settlement agreements but reversed the trial court, reasoning that triable issues of fact prevented sum-

tial liability of community property after division of the assets, but it did not resolve the conflict.

Turning to policy considerations, the court found that the public policy is to protect creditor rights in the context of a division of property upon a divorce. If the court divides the community property (as opposed to it being divided by settlement), then the court "must consider creditor's rights so that there will be sufficient property to satisfy the debt by the person to whom the debt is assigned, provided the net division is equal."

In light of this public policy to protect creditors, if the court divides property, then it would not make sense to allow fraudulent transfers if they were accomplished in a marital settlement agreement. The court reasoned that satisfaction of the debts of the parties should be considered in a marital settlement agreement, even if that results in settlements being more complicated. Similarly, a judgment based on a fraudulent agreement should not be afforded any finality.

In applying the Uniform Fraudulent Transfer Act to the facts of this case, the court held that of the two forms of constructive fraud, the relevant form was that in which the property exchanged was not of reasonably equivalent value and the debtor was insolvent at the time of the transfer or the transfer rendered him insolvent. It was undisputed that the valuation of the medical practice and the real property was a triable issue of fact.

The debate concerned the second part of the test. A debtor is insolvent if the fair value of the debts exceeds the value of the assets. The mother argued that the discounted present value of the future child-support payments should be considered a debt of the husband.

The Supreme Court, reversing the Court of Appeal, rejected the mother's argument. The court reasoned that child support is usually paid from earnings and not from the sale of assets. Also, assets "at the time of dissolution play little part in the computation of child support." Since the husband was not "insolvent" at the time of the transfer, there was no constructive fraud. The court remanded the case for a determination of actual fraud.

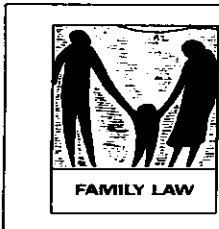
This opinion appears somewhat like a compromise between creditors' rights and the goal of immunizing community property after division from the debts of the other spouse. On the one hand, the Uniform Fraudulent Transfer Act applies to marital settlement agreements. But on the other hand, future support obligations cannot be considered a debt.

A person seeking a child-support order against a married person should obtain a real property lien as soon as possible, and certainly before a marital settlement agreement is signed.

Parties resolving their dissolution case by an agreement can take several steps to protect the judgment from attack by a creditor. The obvious first step is to obtain written appraisals by competent experts. Depending on the value of the assets and the desires of the parties, however, this may not be practical. The downside to obtaining these appraisals, besides the cost, is that the appraisals may undermine the settlement if the values differ from the parties' expectations.

Second, if the debtor was solvent at the time of the transfer, then the records proving this fact should be kept. These records would include appraisals, bank statements, etc. This will allow the debtor to affirmatively prove solvency.

As the court noted, subjecting marital settlement agreements to the Uniform Fraudulent Transfer Act adds one more layer of complexity to dissolution cases. Although formulating a careful settlement of a divorce case already involves many considerations, such as tax implications and issues of valuation, counsel must now analyze whether a judgment is vulnerable to a creditor's claim under the Uniform Fraudulent Transfer Act.



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tive fraud.

In *Mejia*, the husband and wife were married in 1970. The husband, a physician, had a daughter from an extramarital affair in early 1995. A few months later, the wife petitioned for divorce.

The husband and wife settled their dissolution action in a marital settlement agreement that was merged into a judgment. In the agreement, the husband transferred all of his interest in the couple's real property to the wife. The wife transferred her interest in the husband's medical practice to the husband. The agreement provided that the husband would be solely responsible for the child-support obligation from his extramarital affair.

The child's mother filed a paternity action and obtained a child-support order against the husband. It is unclear from the opinion whether this occurred before or after the husband and wife signed the marital settlement agreement.

In the paternity action, the mother filed a lis pendens against the property awarded to the wife in the agreement, apparently after the husband and wife signed the agreement. The court in the paternity action ruled that the mother had no standing to challenge the agreement.

By mid-1997, the husband had abandoned his medical practice and moved in with his mother. He had no assets and little income.

The child's mother then brought the present complaint, seeking a lien against the real property awarded to the wife. The complaint alleged that the marital settlement agreement was a fraudulent transfer intended to hinder her collection of future child support. The husband moved for summary judgment based on

mary judgment.

The heart of the matter is that the Uniform Fraudulent Transfer Act conflicts with the Family Code as follows: The Uniform Fraudulent Transfer Act allows a defrauded creditor to reach property "in the hands of the transferee." But Family Code Section 9136 "protects property transferred to a spouse incident to divorce from the debts of the other spouse." The problem is that neither statute expressly refers to the other.

Both Court of Appeal opinions (*Mejia* and *Gagan*) and the Supreme Court all found that neither the language of the statutes, nor the legislative history, resolved this issue. All three courts examined policy considerations to reach their decisions.

First, the language of the statutes does not resolve this conflict. A transfer is fraudulent under the Uniform Fraudulent Transfer Act if it "is made with actual intent to hinder, delay or defraud a creditor" or if "the debtor did not receive a reasonably equivalent value in exchange for the transfer and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation."

The court stated that other jurisdictions hold that the Uniform Fraudulent Transfer Act applies to marital settlement agreements and that the act should be applied uniformly among states. The court rejected the husband's argument that the Family Code "supplements" the Uniform Fraudulent Transfer Act.

With respect to the Family Code, the immunity of assets awarded to one spouse from the debts of the other is limited only by existing liens. Additionally, the parties may agree to an unequal division of the community property. The court noted, however, that a portion of Family Code Section 916 implies that it may be subordinate to other statutes not contained in that chapter of the Family Code.

The legislative history does not resolve this issue because the history showed that the Legislature was aware of the conflict between creditors seeking to set aside fraudulent transfers and the poten-

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