

Fraudulent Transfer Act Applies to Premarital Agreements

In the recent case of *Sturm v. Moyer*, the California Court of Appeal resolved a question of first impression: Assuming fraudulent intent, can the Uniform Voidable Transactions Act (Civ. Code, § 3439 et seq., formerly known as the Uniform Fraudulent Transfer Act ("Act")) apply to a premarital agreement in which the prospective spouses agreed that upon marriage, each spouse's earnings, income, and other property acquired during marriage will be that spouse's separate property?

In deciding that the Act applies to a premarital agreement, the Court of Appeal reviewed the relevant portions of the Act, and disclosed that it had not found any case from any court in any community property jurisdiction that had addressed this issue.

Sturm had obtained a \$600,000 judgment against Moyer, and he conducted several judgment debtor examinations of Moyer, during which Moyer claimed to have no assets, and claimed that he did not intend to work ever again so he would not have to pay any portion of the judgment. During a judgment debtor examination, Sturm discovered that Moyer had married Jessica Schell after the judgment, and that they had entered into a premarital agreement.

The premarital agreement provided that each party's earnings and income, and any property acquired during the marriage by each spouse, would be that spouse's separate property; each party acknowledged that these earnings, income, and property otherwise would be community property. Sturm argued that Moyer was trying to shield Schell's assets and earnings from the judgment.

Sturm filed a lawsuit against defendants Moyer and Schell, asserting a single cause of action under the Act to set aside the alleged transfer of Moyer's community property interest in Schell's earnings and income, and attempt to have Sturm's earnings and income and assets subject to the Sturm judgment.

Sturm alleged that the Moyer-Schell premarital agreement effected a transfer of Moyer's interest in community property (i.e., Schell's earnings and income), and that the actual intent of this transfer was to hinder, delay, or defraud Moyer's creditors, including Sturm.

At the time of the events at issue in this lawsuit, the Act provided that a transfer made or obligation incurred by a debtor is "fraudulent" as to a creditor, if the debtor made the transfer or incurred the obligation with actual intent to hinder, delay, or defraud any creditor of the debtor. The current version of the Act replaces "fraudulent" with "voidable."

Under California law, all property (with some statutory exceptions) acquired by a married person while domiciled in California is community property (Fam. Code, § 760), and each spouse's respective interests in community property "are present, existing, and equal" during the marriage (Fam. Code, § 751). However, the Family Code allows an

agreement entered into during or before the marriage to change the character of the property acquired during marriage from community property to separate property.

Such an agreement may be made during the marriage under Family Code section 850, and is termed a post-nuptial agreement. Married persons may by agreement or transfer, with or without consideration, do any of the following:

- (a) Transmute community property to separate property of either spouse.
- (b) Transmute separate property of either spouse to community property.
- (c) Transmute separate property of one spouse to separate property of the other spouse.

A transmutation during marriage is subject to the laws governing fraudulent transfers.

The characterization of property as separate or community is important when it comes to liability for debts incurred by either spouse, including debts incurred by a spouse before the marriage. Family Code section 910 provides that the community estate is liable for a debt incurred by either spouse before or during marriage, regardless of which spouse has the management and control of the property, and regardless of whether one or both spouses are parties to the debt or to a judgment for the debt.

Although a married couple's community property is liable for the premarital debts of either spouse, a portion of that community property -- the non-debtor-spouse's earnings and income -- is shielded from liability for that premarital debt to the extent that those earnings and income are held in an account to which the debtor-spouse does not have access and are not commingled.

Resolution of the issue of whether the Act applies to premarital agreements turns on two key questions. First, does such an agreement effect a "transfer" under the Act? A "transfer" under the Act has a broad meaning. It includes every mode, direct or indirect, absolute or conditional, of disposing of or parting with an asset or an interest in an asset. Under this definition, there is no doubt that an agreement made during marriage in which a debtor-spouse agrees that the non-debtor-spouse's future earnings, income, or assets would be the non-debtor-spouse's separate property constitutes a transfer. This question is one of law to be decided by the court.

Second, was the agreement intended to "hinder, delay, or defraud any creditor" of the debtor-spouse? This question is one of fact to be decided based on evidence at trial.

But what if the agreement is made in a premarital agreement? Because the parties are not married when the agreement is entered into, the debtor-spouse has no present and existing interest in the community property represented by the non-debtor-spouse's future earnings, income, and assets. Thus, no transfer takes place because, by the premarital

agreement, the spouses altered the applicability of the community property laws such that neither spouse obtains any interest in community property upon marriage.

On the other hand, the premarital agreement does not become effective until marriage, at which point two things happen -- (1) each spouse obtains a present interest in community property by operation of law and then, (2) by the premarital agreement, each spouse transfers to the other his or her community interest in the other's earnings, income, or other property. So the premarital agreement only triggers the transfer of property during the marriage.

Although not conclusive, the court of appeal found that the legislative history of the Act and the relevant provisions of the Family Code, suggest that the Act applies to premarital agreements. On the whole, public policy considerations favor the interpretation asserted by Sturm.

The decision that the Act can apply to a premarital agreement does not mean that it necessarily will apply to invalidate an agreement. Whether the Act applies in any case depends upon whether there was actual or constructive fraud under Civil Code section 3439.04. That issue is a factual one, and is decided by the evidence at trial.

LESSONS:

1. The Uniform Voidable Transactions Act is a powerful tool to protect creditors in obtaining recovery of the debt owed, and even a premarital agreement may be subject to its remedies.
2. Premarital and post-nuptial agreements can be useful instruments to determine earnings, income and assets during marriage, and confirm if they are separate or community property.