

Premarital Agreements May be Challenged by Third Parties

by Franklin R. Garfield

Premarital agreements are sometimes challenged by a disgruntled spouse upon the dissolution of the parties' marriage. The grounds may be barely plausible or rock solid, but the dispute is between the parties to the agreement. In *Sturm v. Moyer* (February 15, 2019) ___ Cal.App. 5th ___, the Court of Appeal deals with a case of first impression in which the validity of a premarital agreement is challenged by a third party.

In 2004 Sturm obtained a Judgment against Moyer for \$600,000 that was not dischargeable in bankruptcy. Moyer was judgment proof.

In 2014, Moyer married Schell and entered into a premarital agreement that provided that Schell's earnings from employment, ordinarily community property under California law, would instead be Schell's separate property. Sturm filed suit against Moyer and Schell claiming that the premarital agreement constituted a fraudulent transfer of Sturm's community interest in Schell's earnings. The second demurrer to the complaint was sustained without leave to amend by the trial court. The Court of Appeal reversed.

To begin with, the appellate court assumed the allegations of the complaint, if proven, would establish the intent to defraud the creditor. To lay the groundwork for its conclusion, the Court noted as follows:

The UFTA provides 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.” *Calif. Civ. Code* §3439.04.

Section 3439.06(d) provides that “[a] transfer is not made until the debtor has acquired

rights in the asset transferred.”

California Family Code Section 910 states in pertinent part: “Except as otherwise expressly provided by statute, the community estate is liable for a debt incurred by either spouse before or during marriage”

Notwithstanding this provision, “[t]he earnings of a married person during marriage are not liable for a debt incurred by the person’s spouse before marriage so long as they are held in a deposit account in which the person’s spouse has no right of withdrawal and are uncommingled with other property in the community estate, except property insignificant in amount.” *Calif. Fam. Code* §911(a).

Prior to marriage, couples may change the character of property acquired during the marriage from community property to separate property by means of a premarital agreement pursuant to the Uniform Premarital Agreement Act. *Calif. Fam. Code* §1600 *et seq.*

Based on its interpretation of the statutory language and its analysis of the legislative history, the court concluded that the UFTA applies to premarital agreements.

In order to justify that holding, the court had to commit a crime against logic. It acknowledged that a premarital agreement does not become effective until the marriage takes place. *Calif. Fam. Code* §1615. It also acknowledged that neither party acquires community property rights until the marriage takes place. Thus, a premarital agreement becomes effective and a party acquires community property concurrently with the marriage.

There is no justification for concluding that a party acquires community property rights *before* the premarital agreement becomes effective. Whether there will ever be any community property, with or without a premarital agreement, is uncertain. As of the moment the parties say

“I do,” and the premarital agreement becomes effective, there is none. To get around this impediment, the court indulged the fiction that Moyer acquired community property rights in Schell’s earnings during the marriage and then waived those rights in the premarital agreement.

This dubious legal reasoning was necessary to justify the conclusion that the court was determined to reach. After an analysis of the statutes and legislative history that did not resolve the issue, the court decided that protecting a creditor’s rights was more important than respecting the rights of married persons to reorder their property rights.

The court concluded: “[T]he legislature must have intended that UFTA can apply to premarital agreements in which the prospective spouses agree that each spouse’s earnings . . . during the marriage will be that spouse’s separate property. The policy considerations in favor of applicability of the UFTA are especially strong in this case, where the agreement provides that all earnings and income, and property acquired with those earnings and income, dating back to the date of marriage will become community property when certain premarital debts no longer are enforceable, and where the agreement allows the debtor-spouse joint access to the non-debtor spouse’s income and earnings that are deposited in a joint account.”

The defendants in this case were the authors of their own downfall. Moyer testified at his debtor’s examination that he had no assets and that he did not intend to work ever again so he would not have to pay any portion of the judgment. Such statements do not sit well with judicial officers.

If the defendants had not addressed the issue in the premarital agreement, Schell would have been entitled to the benefit of a statutory scheme that exempts her earnings during the marriage from the reach of her husband’s premarital creditors. Of course, a condition of that

protection is that those earnings cannot be deposited into joint accounts. Having re-characterized Schell's earnings as her separate property, the parties were either unaware of that condition or believed that it did not apply.

By incorporating a sunset clause that provided for Schell's earnings and accumulations to become community property retroactively if and when the judgment against Moyer was no longer collectible, the defendants created additional evidence that the transfer could be considered fraudulent.

An obvious criticism of the holding of this case is that the court undermined the integrity of a statutory scheme intended to protect the earnings of a spouse during the marriage by providing that they cannot be reached to satisfy the other spouse's premarital debts. That legislative determination restricts a creditor's rights. Why should those rights be expanded because the parties agree that at some point in the future earnings they chose to characterize as separate would be recharacterized as community?

The notion that Moyer would benefit from Schell's earnings if those earnings were deposited into an account to which he had access, but that he would not benefit from those earnings if they were deposited into an account to which he did not have access, is a distinction without a difference. Either way, if the funds are expended to finance the community's lifestyle, the debtor is advantaged and the creditor is disadvantaged. But restricting the debtor's access to the account in which the earnings are deposited is a condition of the protection afforded by the statutory scheme.

On the one hand, the Court ruled that the UFTA could apply to a premarital agreement. On the other hand, the Court did not rule that any particular agreement, including the one at

issue, would constitute a fraudulent transfer. That depends on whether there is actual or constructive fraud, a factual issue that must be determined by a trial court.

Regardless of whether the underlying case is settled or litigated in the trial court to which it was remanded, *Sturm v. Moyer* is likely to be one of those appellate cases that is confined to its facts. Right or wrong, it is instructive: Parties entering into premarital agreements should avoid creating evidence of intent to hinder, delay or defraud a creditor if one of them has premarital debts.

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