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# Do Ask, Do Tell: California's Spousal Fiduciary Duty And Financial Disclosure Obligations

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# DO ASK, DO TELL: CALIFORNIA'S SPOUSAL FIDUCIARY DUTY AND FINANCIAL DISCLOSURE OBLIGATIONS

*Lauren Rakow\**

*This Note explores the inconsistencies between the Family Code and the Corporations Code addressing whether spouses are required to disclose material information. These inconsistencies have created uncertainty regarding what financial information must be disclosed between spouses, and whether it must be disclosed “upon request” or “without demand.” The Note first analyzes the history of both Family Code Section 721 and Corporations Code Sections 16403, 16404, and 16405 to better understand the uncertainty, and offers a solution to remedy the statutory inconsistencies. The Note concludes that in order to eliminate this uncertainty, the California legislature should amend Family Code Section 721 to clarify what conduct constitutes a breach of fiduciary duty, the type of information that must be disclosed between spouses, and whether information must be disclosed “upon request” or “without demand.”*

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## I. INTRODUCTION

Currently, spouses wed in California may remain married and sue one another for breach of fiduciary duty. In 1992, the California Legislature adopted section 721 (“section 721”) of the California Family Code (“Family Code”) to define the fiduciary relationship between spouses.<sup>1</sup> Family Code section 721(b) incorporates California Corporations Code (“Corporations Code”) Sections 16403, 16404, and 16503.<sup>2</sup> By incorporating provisions of the Corporations Code, Family Code Section 721(b) attempts to clarify that the fiduciary relationship between spouses includes the same rights and duties in the management of community property as the rights and duties of unmarried business partners in the management of partnership property.<sup>3</sup> Particularly, section 721(b) specifies that spouses must disclose to one another material financial information.<sup>4</sup> However, when incorporating the Corporations Code provisions, which require that such financial disclosures be made “without demand,”<sup>5</sup> the Family Code altered the requirement providing that such disclosures must be made only “upon request.”<sup>6</sup> Accordingly, spouses may have actionable breach of fiduciary duty claims against one another for failure to disclose material financial information. However, under section 721(b) there may be a breach of duty for failing to disclose material information “upon request,” whereas under the Corporations Code provision incorporated in section 721(b) there may be a breach for failing to disclose the *same information* even absent a request.<sup>7</sup>

This inconsistency has significant legal and practical implications because, in recent years, hiding assets—or engaging in secretive financial conduct—has become quite common. In fact, according to the Wall Street Journal, 31 percent of spouses or partners who have combined assets admit they have been deceptive about money; 58 percent of these adults have hidden cash; 15 percent

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1. 1992 Cal. Stat. ch. 162.

2. CAL. FAM. CODE § 721(b) (West 2004).

3. 2002 Cal. Stat. 1239–40.

4. FAM. § 721(b)(2).

5. CAL. CORP. CODE § 16403(c) (West 2006).

6. FAM. § 721(b)(2).

7. CORP. § 16403(c); FAM. § 721(b)(2).

say they have a hidden bank account; and 34 percent say they have lied about finances, debt, or money earned.<sup>8</sup> Note, surprisingly, that these statistics refer to the less than 50 percent of couples who *remain* married, not to those who are divorced.<sup>9</sup> Moreover, married couples in California may not know that they have actionable breach of fiduciary duty claims against each other for engaging in such secretive behavior.

Despite the legislative history and numerous California court decisions that have attempted to reconcile and define the fiduciary duty owed between spouses, a great deal of uncertainty remains regarding what financial information must be disclosed between spouses and whether it must be disclosed “upon request” or “without demand.”<sup>10</sup> This uncertainty creates a broad and undefined range of fiduciary duties, which results in an even wider range of legal claims that spouses may bring against each other while they remain married.<sup>11</sup>

It might seem obvious that one spouse should not buy a house using community property assets without disclosing it to the other spouse.<sup>12</sup> It also might seem obvious that a spouse should not take out a substantial loan without telling his or her spouse.<sup>13</sup> But what are the exact limits? What should spouses be required to tell each other regarding community property expenditures? Should spouses unconditionally be required to disclose to one another material

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8. Veronica Dagher, *Why Hiding Money From Your Spouse Has Gotten a Lot Harder*, WALL ST. J., Apr. 30, 2012, <http://online.wsj.com/news/articles/SB10001424052702304356604577337743171120240>.

9. *FastStats-Marriage & Divorce*, CTR. FOR DISEASE CONTROL & PREVENTION, <http://www.cdc.gov/nchs/fastats/divorce.htm> (last updated June 19, 2014).

10. See, e.g., Marshall S. Zolla & Deborah Elizabeth Zolla, *Marital Duty: Current State Law Often Creates a Hobson's Choice When a Spouse Decides Between Separate and Community Property to Fund an Investment Opportunity*, L.A. LAWYER, Feb. 2004, at 20, 24–25 (noting that fiduciary duty legislative enactments and judicial interpretations are imposed on marital relationships but never defined or explained).

11. Peter M. Walzer & Gregory W. Herring, *What Words Don't You Understand—Fiduciary or Duty? In Amending Family Code Section 721, the Legislature Gives Unhappy Couples One More Thing to Fight About*, FAM. L. NEWS, Winter 2003, at 5–6.

12. In fact, Family Code Section 1102(a) prohibits this. “[B]oth spouses, either personally or by a duly authorized agent, must join in executing any instrument by which that community real property or any interest therein is leased for a longer period than one year, or is sold, conveyed, or encumbered.” FAM. § 1102(a).

13. See *In re Marriage of Fossum*, 121 Cal. Rptr. 3d 195 (Cal. Ct. App. 2011) (holding that a wife violated her fiduciary duty to her husband when she took out a \$24,000 loan without disclosing it to him).

transactions, or should they only be required to make such a disclosure once they are asked?

This Note explores those very limits. Specifically, this Note argues that the discrepancy in Family Code Section 721 requires a legislative remedy to ensure that spouses are aware of their rights and duties in the management of community property. Part II of this Note provides an overview and history of the Family Code and the Corporations Code, and it introduces the tensions created by the relationship of those laws. Part III reviews several important decisions and legislative amendments regarding the broad scope of spousal fiduciary duty law and then examines how it has been applied to recent cases. Part IV discusses the costs and far-reaching implications of the statute's broad nature and uncertainty. Part V proposes a legislative remedy, and Part VI applies the proposed statute to existing case law. Finally, Part VII concludes this Note by arguing that without legislative reform, the tension in the Family Law Code will subsist, and married couples and the judiciary will continue to face inconsistencies in the treatment of spousal fiduciary obligations.

## II. FAMILY CODE SECTION 721 AND THE CORPORATIONS CODE

To offer a solution to the discrepancy that exists in Family Code Section 721, it is critical to analyze and understand the histories of both Family Code Section 721 and Corporations Code Sections 16403, 16404, and 16503. The rationales underlying the creation, amendments, and incorporations of each code help reveal the legislature's goals in creating statutory spousal fiduciary duties. Ultimately, understanding the legislative goals will provide a foundation for the proposed statute,<sup>14</sup> which will attempt to clarify the ambiguities inherent in the statute as it currently exists.

### A. *The Family Code*

A long history of spousal fiduciary duty legislation precedes the 1992 enactment of the Family Code. This history loosely mirrors California's legislative changes in marital property law. Accordingly, to evaluate the evolution of spousal fiduciary duty law, it is

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14. See *infra* Part V.

important to examine the contemporaneous legal changes that occurred in California's marital property system.<sup>15</sup>

### 1. California Marital Property Law Pre-1975

The California Constitution was drafted in 1849, one year after California was acquired by the United States.<sup>16</sup> The drafters of the Constitution rejected the then dominant and traditional common law approach to marital property in the United States.<sup>17</sup> Instead, they favored a community property system based on Spanish civil law.<sup>18</sup>

Community property grounded on the Spanish system establishes two categories of marital property: common property and separate property.<sup>19</sup> Common property includes all property acquired by a married person during marriage and is regarded as equally owned by the spouses.<sup>20</sup> Separate property includes property owned before marriage or acquired during marriage by gratuitous transfer and is regarded as separately owned by each spouse.<sup>21</sup>

The distinguishing factor between the traditional common law approach to community property and California's Spanish-based approach is the unification of the husband's and wife's property interests.<sup>22</sup> The common law system favored separation of property.<sup>23</sup> In fact, a wife's property rights were essentially extinguished upon marriage; the husband remained in full control of all marital property unless the spouses explicitly chose common ownership.<sup>24</sup> In contrast, the community property system assumes and encourages common ownership.<sup>25</sup>

While the California legislators retained the Spanish-based distinction between common property and separate property, the

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15. For a complete and detailed background on California's equal management and control jurisprudence, see generally Susan Westerberg Prager, *The Persistence of Separate Property Concepts in California's Community Property System 1849-1975*, 24 UCLA L. REV. 1 (1976-77) (examining California's marital property law).

16. *Id.* at 7.

17. *Id.* at 7-8.

18. *Id.* at 8.

19. *Id.* at 6.

20. *Id.*

21. *Id.* at 6-7.

22. *Id.* at 7.

23. *Id.*

24. See generally *id.* (explaining that a wife's property rights discontinue upon marriage under the traditional common law approach).

25. *Id.*

original 1850 community property legislation did not completely abandon certain male-dominated common law concepts.<sup>26</sup> In fact, the first statute provided the husband with the power to (1) manage and control his separate property; (2) manage and control the common property as if it were his separate property; and (3) manage and control his wife's separate property, with the exception that he could not transfer or encumber her property without her consent.<sup>27</sup>

Although over the years various legislative enactments diminished the husband's total management of and control over marital property,<sup>28</sup> early California law recognized that a spousal fiduciary relationship arose by virtue of the husband's control over their property, rather than by virtue of the "confidential relationship"<sup>29</sup> presumed to exist between spouses.<sup>30</sup>

Not surprisingly, and consistent with all spousal fiduciary duty legislation, the spousal fiduciary relationship was not specifically defined. Simply put, a husband's failure to disclose fully and fairly material facts relating to community assets' value constituted a breach of fiduciary duty.<sup>31</sup> The vague scope of the duty seemed to foreshadow the way spousal fiduciary duties would be defined in the future.

## 2. 1975–1991: Equal Management and Control

In 1975, the California legislature enacted California Civil Code Section 5125, giving husbands and wives equal management of and control over community property.<sup>32</sup> Additionally, the statute reduced the fiduciary duty between spouses to a duty of good faith,<sup>33</sup> which

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26. *Id.* at 26.

27. 1850 Cal. Stat. 254 (current version at CAL. FAM. CODE § 760 (West 2004)).

28. *See* Prager, *supra* note 15, at 47–56 (detailing the "erosion of exclusive male management").

29. "A confidential relationship exists between two persons when one has gained the confidence of the other and purports to act or advise with the other's interest in mind." *Vai v. Bank of Am. Nat'l Trust & Sav. Ass'n*, 364 P.2d 247, 252 (Cal. 1961) (quoting RESTATEMENT (SECOND) OF TRUSTS § 2 comment b).

30. *Id.* at 251–52 ("Because of his management and control over the community property, the husband occupies the position of trustee for his wife in respect to her one-half interest in the community assets . . . [ , and i]t is part of his fiduciary duties to account to the wife.").

31. *Id.* at 255.

32. CAL. CIV. CODE § 5125(a) (1975) (current version at CAL. FAM. CODE § 1100 (West 2004)).

33. The statute provided that

each spouse shall act in good faith with respect to the other spouse in the management and control of the community property in accordance with the general rules which



included “the obligation to make full disclosure to the other spouse of the existence of assets in which the community has an interest.”<sup>34</sup>

In 1991, California Civil Code Section 5125 was amended to replace the good faith standard with a heightened duty of care.<sup>35</sup> The new statute made applicable to the marital relationship the general rules governing fiduciary relationships, and added to the existing duty of disclosure a specific duty to disclose all material facts regarding the characterization and valuation of community assets.<sup>36</sup> It further added a new requirement that a spouse must provide access to “all information, records, and books that pertain to the value and character of those assets.”<sup>37</sup> Of particular importance, however, was that the 1991 amendment made the obligation to make full disclosure and provide access to all information a duty that existed “upon request.”<sup>38</sup>

In sum, fiduciary duty obligations began with an obligation to disclose community assets premised on a husband’s community property control, then in 1975 incorporated a good faith duty to disclose assets, and in 1991 ultimately imposed a heightened fiduciary duty to disclose assets and provide access to records “upon request.” Despite these changes, an explicit definition of spousal fiduciary duty still did not exist. More specifically, these changes failed to establish a precise definition of “adequate disclosure.”

### 3. The Family Code’s Enactment<sup>39</sup>

In 1992, the California legislature enacted the Family Code.<sup>40</sup> California Civil Code Section 5125 became California Family Code

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control the actions of persons having relationships of personal confidence as specified in Section 5103.

*Id.* § 5125(e). California Civil Code Section 5103 merely stated that a husband and wife are subject to the general rules that control the actions of persons occupying confidential relations with each other. *Id.* § 5103 (current version at FAM. § 721).

34. CIV. § 5125(e) (current version at CAL. FAM. CODE § 1100 (West 2004)).

35. California Civil Code Section 5125(e) references the 1991–1992 Regular Session Chapter 1026, which states that “each spouse 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.” 1992 Cal. Stat. 496–97.

36. *Id.*

37. *Id.*

38. *Id.* The legislature did not anticipate that the addition of these two words alone would end up sparking years of litigation, legislative amendments, and this Note.

39. This section closely parallels the history described by the court in the family law case, *In re Marriage of Walker*, 42 Cal. Rptr. 3d 325 (Cal. Ct. App. 2006) (detailing the evolution of the Family Code fiduciary duty statutes).

Section 1100, with no changes.<sup>41</sup> On the other hand, California Civil Code Section 5103<sup>42</sup> was completely supplemented and became Family Code Section 721.

The newly created section 721 acknowledged three important factors. First, the statute provided that a husband and wife were subject to the general rules governing fiduciary relationships.<sup>43</sup> Second, the fiduciary relationship imposed a duty of “the highest good faith and fair dealing on each spouse” and specified that neither spouse should take any unfair advantage of the other.<sup>44</sup> Finally, the statute provided that the spousal fiduciary relationship was subject to the same rights and duties as those of non-marital business partners pursuant to California Corporations Code Sections 15019, 15020, 15021, and 15022. These duties included, but were not limited to providing access to all books, accounting to the spouse, and rendering “upon request” true and complete information with regard to all things affecting community property transactions.<sup>45</sup>

Thus, the original section 721 included its own disclosure “upon request” requirement, and initiated the Family Code’s relationship with the Corporations Code. At this time, the incorporated provisions of the Corporations Code were in harmony with the Family Code. For example, Corporations Code Section 15020 stated that partners shall render to any partner, “on demand,” true and full information of all things affecting the partnership.<sup>46</sup> This was consistent with the

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40. 2002 Cal. Stat. 1239–40.

41. Although California Civil Code Section 5125(e) introduced the concept of financial disclosure “upon request,” the crux of this Note focuses on Family Code Section 721 (former California Civil Code Section 5103), which is incorporated in section 1100(e). *See supra* note 33. Accordingly, it is important to keep in mind that section 1100(e) also requires disclosures and information “upon request.” However, this Note will now shift to, and primarily focuses on, Family Code Section 721. *See In re Marriage of Walker*, 42 Cal. Rptr. 3d at 334 (concluding that section 1100(e)’s incorporation of section 721 and section 721’s requirement to render information “upon request” evidence the legislature’s intent to incorporate a duty requiring spouses to make full disclosures and to provide access that would arise only upon request).

42. *See supra* note 33.

43. CAL. FAM. CODE § 721 (West 1992). The general rules governing fiduciary relationships include those defined in various Corporations Code statutes. *See, e.g.*, CAL. CORP. CODE § 16404 (West 2006) (listing fiduciary duties owed in business partnerships).

44. FAM. § 721(b).

45. *Id.* § 721(b)(1)–(3).

46. CORP. § 15020 (1949) (current version at CORP. § 16403).

right to full disclosure “upon request” found in Family Code Section 721(b)(2).<sup>47</sup>

Essentially, the Family Code as originally enacted was not inconsistent with the incorporated Corporations Code sections; both required disclosures “upon request.” It was not until the Corporations Code was amended that the inconsistencies arose.

### B. *The Corporations Code*

In 1996, sections 15019, 15020, 15021, and 15022 of the Corporations Code were repealed.<sup>48</sup> Key provisions of sections 15019, 15020, and 15021 were replaced<sup>49</sup> by and embodied in new Corporations Code Sections 16403 and 16404.<sup>50</sup> However, the new sections were considerably broader than their predecessors.<sup>51</sup> Specifically, Corporations Code Section 16403, titled “Book and records; right of access,” requires each partner to furnish to a partner “without demand, any information concerning the partnership’s business and affairs reasonably required for the proper exercise of the partners’ rights and duties,” and “on demand, any other information concerning the partnership’s business and affairs.”<sup>52</sup>

This amendment created a serious ambiguity in the Family Code. The previously consistent Family Code Section 721, which required marital partners to render information of all things affecting the partnership “upon request,” now unofficially<sup>53</sup> incorporated a statute that required partners to disclose essential information without a request or a demand.<sup>54</sup> The difference between these two phrases created uncertainty regarding the duty of disclosure that

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47. See FAM. § 721(b)(2). Other similarities included the requirements, found in Family Code Section 721(b)(1) and Corporations Code Section 15019, that spouses provide access to any books for inspection and copying and the duty to provide an accounting found in Family Code Section 721(b)(3) and Corporations Code Sections 15021 and 15022. FAM. § 721(b)(2)–(3); CORP. §§ 15019, 15021–22 (1949) (current versions at CORP. §§ 16403–04, 16503).

48. 1996 Cal. Stat. 5908–59.

49. Section 15022 was not replaced.

50. *In re* Marriage of Walker, 42 Cal. Rptr. 3d 325, 335 (Cal. Ct. App. 2006).

51. *Id.*

52. CORP. § 16403(c)(1)–(2).

53. Family Code Section 721 was not simultaneously amended in 1996 to reflect the revised and replaced Corporations Code sections. Instead, it reflected the old Corporations Code Sections 15019, 15020, 15021, and 15022 until the Family Code was again amended in 2002. CAL. FAM. CODE § 721 (West 2004).

54. The new Corporations Code Sections 16404 and 16503 prescribed partners’ fiduciary duties and the effect of transfer of partners’ transferable interests, respectively. CORP. §§ 16404, 16503.

spouses owe one another and whether such disclosure should be made “upon request” or “without demand.”<sup>55</sup>

### III. *IN RE MARRIAGE OF DUFFY* AND ITS EFFECT

*In re Marriage of Duffy*<sup>56</sup> was the first major case to recognize and attempt to reconcile the ambiguity resulting from the Corporations Code amendments.<sup>57</sup> Unfortunately for the *Duffy* court, the legislature criticized its narrow understanding of spousal fiduciary duties and deemed its interpretation of Family Code Section 721 incorrect.<sup>58</sup> Consequently, as explained below, the legislature amended the Family Code in an attempt to resolve both the statute’s original ambiguity, and the added confusion from the *Duffy* decision.<sup>59</sup> However, the amended statute vaguely broadened spousal fiduciary duties and again left the courts with the task of interpreting its ultimate meaning.

#### A. *In re Marriage of Duffy Case Background and Holding*

In 1997, Vincent and Patricia Duffy separated after thirty-four years of marriage.<sup>60</sup> Early in their marriage, Patricia had managed the parties’ checkbook.<sup>61</sup> However, after Patricia had failed to record checks properly, Vincent had taken complete charge of the family’s finances.<sup>62</sup> Throughout their marriage, Vincent had made a series of investments of which Patricia had minimal knowledge.<sup>63</sup> In 1983, Vincent had received a severance package from his employment at MCA Records,<sup>64</sup> which included 3,901 shares of MCA stock and \$157,590.40 in cash from a profit-sharing plan that Vincent later had

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55. See *In re Marriage of Duffy*, 111 Cal. Rptr. 2d 160, 165 (Cal. Ct. App. 2001).

56. *Id.*

57. *Id.*

58. 2002 Cal. Stat. 1239–40.

59. *Id.*

60. *Duffy*, 111 Cal. Rptr. 2d at 162.

61. *Id.*

62. *Id.*

63. *Id.* at 162–63. Those investments included real estate, an auto body shop, a house in Arizona, and a \$50,000 loan to Vincent’s childhood friend. *Id.* Sometimes, Vincent and Patricia would discuss these ventures before investing, and sometimes Patricia would find out about them after asking. *Id.*

64. *Id.* at 163.

placed in an IRA account at a brokerage firm.<sup>65</sup> Shortly thereafter, Vincent had sold the MCA stock.<sup>66</sup>

By 1995, Vincent had built a stock portfolio, and he had transferred the IRA brokerage account to another brokerage company; the IRA account had contained \$482,925.<sup>67</sup> Following his stockbroker's advice, Vincent had bought and sold technology stocks, which, at first, had resulted in an increase in the value of the brokerage account.<sup>68</sup> Sometime in 1996, however, on the advice of his stockbroker, Vincent had invested his entire portfolio in one of the technology stocks.<sup>69</sup> By 1998, the value of the IRA account had depreciated to \$261,483.<sup>70</sup>

Throughout this time period, Patricia was aware that Vincent had opened a brokerage account but had not realized that the MCA stock had not been reflected on the brokerage statements.<sup>71</sup> She never had asked Vincent any questions regarding the brokerage account.<sup>72</sup>

In Vincent and Patricia's divorce proceeding, the lower court found that Vincent had breached his fiduciary duties to Patricia in several respects.<sup>73</sup> Specifically, the trial court relied on expert witnesses who opined that Vincent had invested the MCA assets in a risky and unsuccessful investment.<sup>74</sup> The breach of fiduciary duty was a result of Vincent's failure to either consult with Patricia or obtain her advice or agreement regarding the investments.<sup>75</sup> The court further held that Vincent's failure to respond to Patricia when she attempted to question Vincent about their financial affairs constituted a breach of fiduciary duty.<sup>76</sup>

The court of appeal reversed the lower court's holding.<sup>77</sup> It held that there was no evidence that Patricia had ever sought information about the investment of the MCA assets, and therefore Vincent could not have breached his fiduciary duty of full disclosure "upon

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65. *Id.*

66. *Id.*

67. *Id.*

68. *Id.*

69. *Id.*

70. *Id.* at 163–64.

71. *Id.* at 164.

72. *Id.*

73. *Id.* at 165.

74. *Id.* at 164.

75. *Id.*

76. *Id.*

77. *Id.* at 167.

request.”<sup>78</sup> The court of appeal then discussed whether Vincent had breached a fiduciary duty other than the statutory duty of full disclosure upon request.<sup>79</sup> Specifically, the court examined “whether the fiduciary duty owed by the spouse managing community assets to the other spouse includes a duty of care,” which was a duty set forth in the incorporated Corporations Code Section 16404.<sup>80</sup> The court reasoned that the rights and duties specifically enumerated in Family Code Section 721, and “echoed” by the incorporated Corporations Codes, were the only duties owed between spouses.<sup>81</sup> Accordingly, because the duty of care found in Corporations Code Section 16404 was not “echoed” in Family Code Section 721, it was excluded from the fiduciary duties owed between spouses.<sup>82</sup> The legislature immediately reacted.

### *B. Reaction to Duffy: The 2002 Family Code Amendments*

In 2002, one year after the *Duffy* decision, Family Code Section 721 was amended to both abrogate the ruling in *Duffy* and to clarify that Section 721 of the Family Code provides that the fiduciary relationship between spouses includes all of the same rights and duties in the management of community property as the rights and duties of unmarried business partners managing partnership property, as provided in Sections 16403, 16404 and 16503 of the Corporations Code . . . .<sup>83</sup>

Accordingly, section 721 as amended, and as it currently exists, imposes a duty of the highest good faith and fair dealing between spouses and subjects spouses to the general rules governing fiduciary relationships of non-marital business partners.<sup>84</sup> The rights and duties enumerated in the Family Code include, but are not limited to,<sup>85</sup>

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78. *Id.*

79. *Id.* at 167–68.

80. *Id.* at 168.

81. The court reasoned that the legislature had deleted the words “but not limited to” from the phrase “including, but not limited to” from the enumerated rights in section 721 because it intended to limit the scope of section 721 to those rights included or enumerated. *Id.* at 171–72.

82. *Id.* at 172. The legislature “eliminated the possibility that [Family Code Section 721] subdivision (b) could be interpreted expansively.” *Id.*

83. 2002 Cal. Stat. 1239.

84. CAL. FAM. CODE § 721 (West 2004).

85. The 2002 amendment included the addition of the words “but not limited to” to the phrase “including, but not limited to.” 2002 Cal. Stat. 1239.

providing each spouse with access to all books and records, rendering “upon request” information of all things affecting transactions related to community property, and accounting to the spouse.<sup>86</sup> The rights and duties provided in the incorporated Corporations Codes include, but are not limited to<sup>87</sup> a duty of loyalty, a duty of care,<sup>88</sup> and a duty to render “without demand, any information concerning the partnership’s business and affairs.”<sup>89</sup>

While the 2002 amendments expanded the scope of spousal fiduciary duties to include those in the Corporations Code, they did so without specificity. In fact, and yet again, the legislature failed to delineate what information spouses must disclose to one another and what constitutes adequate disclosure.<sup>90</sup> Further, the amendments did nothing to clarify the ambiguity in incorporating a Corporations Code that requires disclosure “without demand” into a statute that requires disclosure “upon request.” Thus, the courts were left with the task of independently interpreting the statute.

### C. *Subsequent Application of Family Code Section 721*

California courts have subsequently addressed the question of what constitutes a breach of spousal fiduciary duty. Each decision proves that finding a breach is highly dependent upon how the court chooses to view the facts and rationalize its holding. In other words, the amendments failed to develop a precise explanation of spousal fiduciary duties by, once again, leaving them unlimited in scope and ambiguous in definition. Accordingly, courts have applied their own constructions of the statute.

#### 1. *In re Marriage of Margulis*

In *In re Marriage of Margulis*,<sup>91</sup> Alan and Elaine Margulis separated after a thirty-three-year marriage.<sup>92</sup> For twelve post-separation years, Alan had complete control of their community

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86. FAM. § 721(b)(1)–(3).

87. *See supra* note 85.

88. The duty of care includes “refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.” CAL. CORP. CODE § 16404(c) (West 2006).

89. CORP. §§ 16403–04.

90. *See* Walzer & Herring, *supra* note 11, at 6. (noting that despite the legislature’s efforts to clarify the specific duty one spouse owes to the other, Family Code Section 721 still is unclear).

91. 130 Cal. Rptr. 3d 327 (Cal. Ct. App. 2011).

92. *Id.* at 330.

investment accounts.<sup>93</sup> Just before their divorce trial, Alan “disclosed for the first time that the once-brimming investment accounts were virtually empty.”<sup>94</sup>

The court of appeal held that Alan had breached the fiduciary duties of disclosure and accounting that he owed to Elaine.<sup>95</sup> The court held that Alan had been obligated, as a managing spouse, to disclose the existence and disposition of all community assets and then to account for that property.<sup>96</sup> The court further noted that section 721’s specific incorporation of the requirement to furnish information “without demand”<sup>97</sup> created an “affirmative and broad” obligation to disclose relevant information concerning community property transactions.<sup>98</sup>

## 2. *In re Marriage of Fossum*

The court of appeal upheld another finding of breach of spousal fiduciary duty in *In re Marriage of Fossum*.<sup>99</sup> There, Sandra Fossum had taken out a \$24,000 cash advance on her credit card, had transferred the funds into her personal bank account, and never had disclosed the transaction to her husband, Edward.<sup>100</sup> Sandra had used about \$13,500 of the cash, without Edward’s permission or knowledge, to purchase a horse trailer and a car for her son from a prior relationship.<sup>101</sup>

The trial court held, and the court of appeal affirmed, that Sandra had incurred the debt without disclosure to Edward in violation of her fiduciary duty pursuant to Family Code Section 721.<sup>102</sup> Although the court did not specify whether Sandra should have disclosed the cash advance “upon request” or “without demand,” it can be assumed that the court was using a “without demand” standard as its holding was simple and concise: “[I]t was

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93. *Id.*

94. *Id.*

95. *Id.* at 339–40.

96. *Id.*

97. In other words, the court was relying on Corporations Code Section 16403. *Id.* at 339.

98. *Id.*; see Marshall S. Zolla, et al., *Mediation Confidentiality vs. Breach of Spousal Fiduciary Duty: The Clash of Enshrined Public Policy Titans*, 2012 FAM. L. NEWS 163, 168 (“*Margulis* reinforces the duty of spouses to account for assets under their management and control, strengthening the doctrine of the fiduciary duty owed by one spouse to the other.”).

99. 121 Cal. Rptr. 3d 195, 200 (Cal. Ct. App. 2011).

100. *Id.*

101. *Id.*

102. *Id.* at 204–05.



undisputed that Sandra incurred the debt without disclosure to Edward, in violation of her fiduciary obligations to her spouse and the provisions of Section 721.”<sup>103</sup> This holding indicates that a breach of fiduciary duty based on a simple failure to disclose equates to a breach based on a “without demand” standard.

### 3. *In re Marriage of Rossi*

The court’s explicit application of a “without demand” standard in *In re Marriage of Margulis*,<sup>104</sup> and its implicit application of the same in *In re Marriage of Fossum*,<sup>105</sup> contrasts with the court’s ambiguous rationalization in *In re Marriage of Rossi*.<sup>106</sup> There, Denise and Thomas were married for twenty-six years before they separated.<sup>107</sup> One year before their separation, Denise had won \$1,336,000 from a lottery jackpot pool she had entered into with a group of her co-workers.<sup>108</sup> Denise had concealed her winnings from Thomas and had not listed her winnings on the schedule of assets and debts as required by their marital settlement agreement.<sup>109</sup> After judgment of marital dissolution had been entered and Thomas had filed for bankruptcy, he received a letter at his home asking if Denise was interested in a lump-sum buyout of her lottery winnings.<sup>110</sup> This was the first time that Thomas heard about Denise winning the lottery.<sup>111</sup>

The trial court held, and the court of appeal affirmed, that Denise had breached her fiduciary duty under Family Code Section 721 by fraudulently failing to disclose the lottery winnings and intentionally breaching her warranties in the marital settlement agreement.<sup>112</sup> Although the court cited to section 721, it did not clarify whether it was using a “without demand” or an “upon

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103. *Id.* at 204.

104. 130 Cal. Rptr. 3d 327, 339 (Cal. Ct. App. 2011).

105. 121 Cal. Rptr. 3d 195, 204 (Cal. Ct. App. 2011).

106. 108 Cal. Rptr. 2d 270, 275–78 (Cal. Ct. App. 2001).

107. *Id.* at 272.

108. *Id.* According to Denise, her coworkers wanted to give Denise a share in the jackpot as a gift because the group won after Denise had withdrawn from the pool. *Id.*

109. *Id.* at 272–73. Each party to the marital settlement agreement warranted that he or she (1) had possessed no property whatsoever other than the property specifically mentioned in the agreement and (2) had disclosed fairly all of the property in which either had an interest, whether it was separate or joint property. *Id.* at 273.

110. *Id.*

111. *Id.*

112. *Id.* at 274, 278.

request” standard in evaluating Denise’s conduct.<sup>113</sup> Instead, the court highlighted how Denise’s intentional concealment of the lottery winnings had amounted to fraud and warranted the most severe sanction under Family Code Section 1101(h);<sup>114</sup> Denise had to pay Thomas 100 percent of the lottery winnings.<sup>115</sup>

The court’s holding can be interpreted in two ways. On the one hand, the court may have used the “upon request” standard from section 721, implying that the marital settlement agreement disclosures operated as a request, and Denise’s intentional concealment, despite such a request, constituted a breach.<sup>116</sup> On the other hand, the court may have used the Corporations Code “without demand” standard, simply implying that winning the lottery constitutes information that must be disclosed between spouses.<sup>117</sup>

These opinions demonstrate that in amending Family Code Section 721, the legislature provided little guidance for husbands, wives, and even courts regarding what financial information must be disclosed between spouses. It also shows a lack of certainty regarding whether such information must be disclosed “upon request” or “without demand.” Although the legislature noted that its amendments to the Family Code were an attempt to clarify the scope of spousal fiduciary duties,<sup>118</sup> the reality is that the amendments broadened the duties to a scope incapable of definition. The lack of clarity has far-reaching consequences for marital relationships and for the court system.

#### IV. THE FAMILY CODE’S UNCERTAINTY HAS WIDESPREAD IMPLICATIONS

It has been claimed that spouses view the terms imposed upon their marriage contracts as unexpected.<sup>119</sup> Even worse, it has been contended that spouses discover the terms of their marriage contracts

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113. *Id.* at 275.

114. CAL. FAM. CODE § 1101(h) (West 2004) (awarding 100 percent of any asset undisclosed when the breach of fiduciary duty is based on fraud).

115. *Rossi*, 108 Cal. Rptr. 2d at 275.

116. *Id.* at 276.

117. *Id.*

118. 2002 Cal. Stat. 1239–40.

119. Lynn A. Baker & Robert E. Emery, *When Every Relationship Is Above Average: Perceptions and Expectations of Divorce at the Time of Marriage*, in FAMILY LAW IN ACTION: A READER 73, 73 (Margaret F. Brinig, et al. eds., 1999) (evaluating empirical evidence of young adults’ views about the laws of divorce).

only upon divorce.<sup>120</sup> The fiduciary duty statutes present the same issue. In fact, the “combustible mix of disclosures, decisions, and duties that affect [community] money, investments, businesses and financial well-being” are not even listed in marriage contracts but are rather duties spouses assume without any forewarning.<sup>121</sup> Accordingly, if spouses are unaware of the fiduciary duties owed to one another, they must also be unaware of whether they are complying with the requirements.<sup>122</sup>

Additionally, the broad nature of the statute and the inconsistent precedent has essentially made spouses accountable to one another for every transaction involving community property.<sup>123</sup> The result is a new category of “fiscal misfeasance” that courts will need to address.<sup>124</sup> Specifically, courts will be faced with reviewing “every transaction during marriage, every opportunity lost, and every debt incurred with an eye to a potential breach of fiduciary duty.”<sup>125</sup> Every communication—or lack thereof—between spouses regarding community property transactions will require thorough analysis, and attorneys will need to carefully scrutinize and advise their clients on every marital transaction.<sup>126</sup>

It is surprising that a statute with the purpose of facilitating spousal communication<sup>127</sup> has become a source of confusion and a medium through which spouses may bring an indefinite amount of fiduciary duty claims against one another. To reinforce the statute’s original goals and to provide spouses and courts with consistency and awareness, Family Code Section 721 must be amended.

## V. PROPOSAL

Given the difficulty of complying with Family Code Section 721, the inconsistent precedent, and the burdensome costs of

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120. *Id.*

121. Zolla & Zolla, *supra* note 10, at 25.

122. *Id.* at 24 (noting that if no notice is given to spouses regarding fiduciary duty obligations and marital property is utilized for an investment, the undisclosed profits are susceptible to a breach of fiduciary duty claim with potentially draconian results).

123. Walzer & Herring, *supra* note 11, at 6.

124. *Id.*

125. *Id.*

126. *Id.* at 6–7.

127. *See, e.g., In re Marriage of Margulis*, 130 Cal. Rptr. 3d 327, 343 (Cal. Ct. App. 2011) (noting the statutory purposes of “requiring complete transparency and accountability in the management of community assets”); *In re Marriage of Haines*, 39 Cal. Rptr. 2d 673, 685 (Cal. Ct. App. 1995) (suggesting that Family Code Section 721 is a statute of “mutual accountability”).

fiduciary duty legislation to both marital relationships and to the courts, the California legislature should again amend Family Code Section 721. The legislature should clarify what conduct constitutes a breach of fiduciary duty, the type of information that must be disclosed between spouses, and whether such information must be disclosed “upon request” or “without demand.” The essence of the amendment should reflect the requirements set forth in the California Corporations Code but should not include the Corporations Code itself.<sup>128</sup>

First, the legislature should eliminate from Family Code Section 721(b) the incorporation of Corporations Code Sections 16403, 16404, and 16503. The legislature should instead use these Corporations Code sections as a model to fashion a guided and limited Family Code statute. Specifically, the legislature should take the Corporations Code language that sets forth non-marital business partners’ fiduciary duties and obligations, apply them to marital relationships, and explicitly list them in Family Code Section 721(b).<sup>129</sup>

For example, Corporations Code Section 16404 states that the duty of loyalty to a partnership includes refraining from appropriating partnership opportunities and self-dealing transactions.<sup>130</sup> Accordingly, in amending Family Code Section 721(b), the legislature should explicitly add (1) that spouses owe each other a duty of loyalty and (2) that the duty of loyalty includes refraining from entering into self-dealing transactions and appropriating opportunities that would otherwise benefit the community. The legislature should similarly add and specify every

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128. Modeling the Family Code after the Corporations Code is consistent with the idea of marriage as a business partnership. Family law literature has increasingly described marriage as a “miniature firm” and often compares marriage to non-marital business partnerships. FAMILY LAW IN ACTION: A READER, *supra* note 119, at 135; *see also*, MILTON C. REGAN JR., ALONE TOGETHER: LAW AND THE MEANINGS OF MARRIAGE 33–36 (1999) (applying the economic paradigm to marriage). *See generally* GARY BECKER, A TREATISE ON THE FAMILY: ENLARGED EDITION (1991) (presenting an economic approach to the family). However, eliminating the Corporations Code recognizes that although marriage is contractual in nature, it is not a commercial partnership. *See In re Marriage of Bonds*, 5 P.3d 815, 829–30 (Cal. 2000) (distinguishing marriage contracts from commercial contracts).

129. The fiduciary duties added by this amendment would not replace the existing enumerated duties in section 721(b) but would instead be added on. As noted, the existing enumerated duties in section 721(b) include access and inspection of books, disclosures (addressed below), and accounting. CAL. FAM. CODE §§ 721(b)(1)–(3) (West 2004).

130. CAL. CORP. CODE § 16404(b) (West 2006).

other fiduciary duty owed between spouses as exists in the Corporations Code between business partners.<sup>131</sup>

Second, the legislature should eliminate the “upon request” standard of disclosure and, similar to Corporations Code Section 16403, add language requiring disclosure “without demand”<sup>132</sup> of any information concerning transactions *substantially affecting the existence, characterization, and valuation of community property assets*.<sup>133</sup> The legislature should specify that information of this nature includes, but is not limited to,<sup>134</sup> the following: loans; retirement accounts; life insurance; purchases and sales of stock; purchasing, encumbering, and selling real property;<sup>135</sup> extraordinary purchases or sales of assets; and extraordinary credit and debit card transactions.<sup>136</sup>

The legislature should further mirror the language found in Corporations Code Section 16403 and add a requirement for disclosure “on demand” of any other information concerning community property, “except to the extent the demand or the information demanded is unreasonable or otherwise improper under the circumstances.”<sup>137</sup>

As a result of these changes, Family Code Section 721 would set forth, in a single statute, an explicit list of fiduciary duties owed between spouses and the disclosures required to avoid a breach of those duties. Beginning the statute with a list of fiduciary duties serves two functions: it explicitly informs spouses of their obligations, and it highlights the duty of disclosure by familiarizing

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131. *See id.* § 16404(c).

132. Note that this change would require the legislature to amend Family Code Section 1100(e) to reflect a “without demand” standard to avoid further inconsistencies between the statutes.

133. The “existence, characterization, and valuation” of assets is language taken from Family Code Section 1100(e). FAM. § 1100(e).

134. The phrase “including, but not limited to” obviates the need for a catchall provision. It leaves the statute open ended enough to account for situations that courts and the legislature might otherwise not expect but also will prevent spouses from bringing frivolous claims. The legislature should warn the courts that the phrase is to be construed strictly and that the scope of duties should be expanded only when it is deemed absolutely necessary for equitable reasons.

135. *See* FAM. § 1102(a).

136. This amendment would not apply to the management of community property businesses. *See id.* § 1100(d) (specifying certain notice requirements regarding community property businesses).

137. CAL. CORP. CODE § 16403(c)(2) (West 2006).

spouses with the types of conduct that would also constitute a breach of the disclosure requirement.

For example, a fiduciary duty prohibiting self-dealing transactions in the marital context would cover any transactions that benefit only one spouse, such as hiding lottery winnings. This is the same type of conduct that involves the “existence,” or even the “valuation,” of community assets for which disclosure would be necessary “without demand.”<sup>138</sup> Accordingly, this amendment would inherently provide spouses with examples of *conduct* that may also constitute a breach of the duty of disclosure, as opposed to merely providing spouses with the type of *information* that must be disclosed.

Additionally, section 721 would require disclosure “without demand” of information regarding the disposition of community assets. By including the word “substantial” when referring to the transaction at issue, the statute would provide for a duty of disclosure only when a transaction would significantly affect the “existence, characterization, [or] valuation” of community assets. The transaction’s significance would depend on the total amount of community assets. For example, a \$5,000 purchase may not “substantially” affect the “valuation” of community assets for a couple with one million dollars in savings, but may be substantial for a couple with \$20,000 in total assets. Alternatively, winning a lottery mega-jackpot is likely to “substantially” affect the existence of community assets, regardless of a couple’s net worth.<sup>139</sup>

Finally, section 721’s requirement of disclosure “on demand” of any other information is not a catchall provision<sup>140</sup> but instead simply provides that if one spouse asks the other spouse anything about community assets, the latter should answer honestly.<sup>141</sup>

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138. *See id.* § 16403(c)(1) (explaining that the code requires furnishing “without demand, any information concerning the partnership’s business and affairs reasonably required for the proper exercise of the partner’s rights and duties”). Another example is appropriating opportunities that would otherwise benefit the community in the marital context, including risky stock investments and personal IRA accounts, which similarly involve the “existence, characterization, and valuation” of community assets.

139. This same point can be made regarding the word “extraordinary” in the disclosure requirement for “extraordinary purchases, and extraordinary credit and debit card transactions.” Whether a transaction is “extraordinary” would be relative to the total amount of assets and would determine whether it should be disclosed “without demand.”

140. *See supra* text accompanying note 134.

141. The legislature would need to clarify that the “on demand” standard is genuinely that narrow. It is not meant to blur the dividing line between “without demand” and “on demand.” Its

These proposed changes to Family Code Section 721 would add valuable clarity to the issues surrounding spousal fiduciary duties. Furthermore, these changes would provide spouses with a single statute setting forth their duties and obligations with respect to community assets and would better guide the courts in determining whether a breach of fiduciary duty exists.

## VI. APPLICATION

Applying the proposal above to the existing case law<sup>142</sup> suggests that amending Family Code Section 721 would successfully provide spouses and courts with uniform guidelines from which they may evaluate conduct or disclosures for potential breaches of spousal fiduciary duties. Such a statute would be a step in the right direction toward bringing both consistent precedent in the courts, and clarity for spouses regarding their fiduciary obligations to each other.

### A. *In re Marriage of Margulis*

In *In re Marriage of Margulis*, the court held that Alan Margulis had breached the fiduciary duty of disclosure that he owed to his wife, Elaine, for failing to disclose that their community investment accounts were “virtually empty.”<sup>143</sup> Under the proposed statute, Alan would have had a clear and defined duty of disclosure under two of the statutory provisions. First, the proposed statute requires disclosure “without demand” of transactions that substantially affect the existence and valuation of community property assets. Here, Alan’s stock transactions had nearly zeroed-out the community investment account.<sup>144</sup> Clearly, the existence and value of community assets had been changed significantly; the assets no longer existed and their value had been diminished vastly.<sup>145</sup> Second,

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purpose would be to require an honest response, or disclosure, when a spouse is asked about community assets. However, it is important to note that the line may foster future litigation regarding asset information that a spouse might want to keep private or not disclose at all. Perhaps those issues might be considered “unreasonable or otherwise improper” under the second clause of the proposed amendment. This argument is recognized but exceeds the scope of this Note.

142. *See supra* Part III.

143. *In re Marriage of Margulis*, 130 Cal. Rptr. 3d 327, 338–44, 350 (Cal. Ct. App. 2011).

144. *Id.* at 333.

145. *Id.* Although the proposed statute provides that whether a transaction is “substantial” depends on the total amount of community assets, it seems obvious that “zero-ing out” any community account is a substantial transaction. The provision referring to total assets is likely

buying and selling stock is enumerated in the proposed statute as a required disclosure “without demand.” Thus, even if the diminution in the accounts had not occurred, Alan would have breached his duty by failing to disclose what he was doing with the investment.

Accordingly, under the proposed amendment, Alan would be provided with one statute containing explicit language defining the duties he owed to Elaine. Although the court also used a “without demand” standard, the court grounded its interpretation on the incorporated Corporations Code requirements.<sup>146</sup> Under the proposed amendment, Alan would neither have had to jump to various statutes to figure out his duties nor would he have had to interpret how spousal fiduciary duties parallel business partnership fiduciary duties.

### B. In re Marriage of Fossum

In *In re Marriage of Fossum*, the court held that Sandra Fossum had incurred a \$24,000 debt without disclosure to her husband, Edward, in violation of her fiduciary duty pursuant to Family Code Section 721.<sup>147</sup> If the proposed statute were applied to *In re Marriage of Fossum*, Sandra would have breached her fiduciary duty under three different theories. First, Sandra would have breached her fiduciary duty of loyalty by engaging in a self-dealing transaction. Sandra had used the cash advance for major asset purchases for her use only.<sup>148</sup> Second, Sandra would have breached her duty of care; secretly obtaining a cash advance and using it for major asset purchases that may have been financially imprudent could be reckless or intentional misconduct.<sup>149</sup> Finally, Sandra would have breached her duty of disclosure similar to the way Alan did in *In re Marriage of Margulis*. Not only did the \$24,000 advance substantially decrease the “value” and diminish the “existence” of the Fossum’s assets, but it would also be considered an “extraordinary” credit card transaction as enumerated in the proposed statute.

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more useful in the context of an account that merely depreciated in value, not one that lost all value.

146. *Id.* at 339.

147. 121 Cal. Rptr. 3d 195, 204 (Cal. Ct. App. 2011).

148. *Id.* at 200.

149. *See supra* note 88.



Consequently, *In re Marriage of Fossum* represents a situation in which listing the explicit fiduciary duties together with the disclosure requirements highlights the duty of disclosure. Sandra's conduct, and the type of information she failed to disclose, each separately constitutes a breach of fiduciary duty under the proposed statute. This type of consistency within the statute informs spouses of their duties by emphasizing the types of behavior that are especially objectionable—those that violate the statute in more ways than one.

### C. In re Marriage of Rossi

In *In re Marriage of Rossi*, the court found that Denise Rossi had breached her fiduciary duty by fraudulently failing to disclose to her husband, Thomas, that she had won the lottery and by intentionally breaching her warranties in their marital settlement agreement.<sup>150</sup> The same analysis as applied to Sandra in *In re Marriage of Fossum* may be applied here, even though Denise made money rather than incurred a debt. Under the proposed amendment, Denise would similarly have breached her fiduciary duty of loyalty, her duty of care,<sup>151</sup> and her duty of disclosure “without demand.” However, Denise would potentially be guilty of a breach under a fourth theory pursuant to the proposed amendment. As noted in Part III, the marital settlement agreement may have constituted a request or demand for information.<sup>152</sup> If this interpretation were applied, Denise breached her fiduciary duty for failing to answer honestly “on demand.”

## VII. CONCLUSION

The existing Family Code provides that spouses may breach a fiduciary duty for failing to disclose material information “upon request,” while the Corporations Code provision incorporated in Family Code Section 721(b) provides that there may be a breach for failing to disclose the *same information* even absent a request.<sup>153</sup> This tension has created ambiguities regarding what financial information must be disclosed between spouses, and whether it must

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150. *In re Marriage of Rossi*, 108 Cal. Rptr. 2d 270, 276 (Cal. Ct. App. 2001).

151. In fact, Thomas would have an even stronger case for breach of the duty of care against Denise as the court emphasized that its holding was based on Denise's fraudulent and intentional concealment. *Id.*

152. *See supra* Part III.C.

153. CAL. CORP. CODE § 16403(c) (West 2006); CAL. FAM. CODE § 721(b)(2) (West 2004).

be disclosed “upon request,” or “without demand.” To resolve this tension, the California legislature should amend Family Code Section 721 to clarify what conduct constitutes a breach of fiduciary duty, the type of information that must be disclosed between spouses, and whether information must be disclosed “upon request” or “without demand.” These changes would provide spouses with a single statute setting forth their duties and obligations with respect to community assets, and would better guide the courts in determining whether a breach of fiduciary duty exists. Without any, or similar, legislative reform, the tension in the Family Code will subsist, and married couples, and the judiciary, will continue to face uncertainty regarding spousal fiduciary duties.

