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PERSPECTIVE

## COVID-19 divorce and marital property agreements

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COVID-19 has caused unemployment, financial stress, death and illness, lockdowns and confinement. These and other factors strain, and can cause irreparable damage to, relationships and marriages. Coronavirus divorces are expected to increase as are bankruptcy filings. This article reviews key concepts regarding property settlements incident to divorce and fraudulent transfer laws and discusses the treatment of these settlements in bankruptcy cases.

### Marital Settlement Agreements

When divorcing couples agree upon a property division, no law requires them to divide the property equally. Divorcing couples may enter into a marital property or settlement agreement therefore that may or may not divide the property equally. Creditors may scrutinize the MSA, however, and, as shown below, challenge the MSA as fraudulent.

### Fraudulent Transfer Law

The California Uniform Voidable Transactions Act, California Civil Code Section 3439 et seq, formerly known as the Uniform Fraudulent Transfer Act, provides that transfers can be avoidable (invalid) because of actual or constructive fraud.

California Civil Code Section 3439.04(a)(1) provides that a transfer is avoidable if made with the actual intent to hinder, delay or defraud any creditor.

California Civil Code Section 3439.04(a)(2) provides one form of constructive fraud. The section provides that a transfer is avoidable as to an existing or future creditor if the debtor did not receive a reasonably equivalent value and either: “[w]as engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably

small in relation to the business or transaction or [i]ntended to incur, or believed or reasonably should have believed that the debtor would incur, debts beyond the debtor’s ability to pay as they became due.”

California Civil Code Section 3439.05 provides a second form of constructive fraud. The section provides that transfer is avoidable as to an existing creditor if the debtor made the transfer without receiving a reasonably equivalent value and “the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer.”

### The Mejia Decision

In *Mejia v. Reed*, 31 Cal. 4th 657 (2003), Reed had an extramarital relationship with Mejia that led to the birth of a child. In a subsequent divorce proceeding, Reed and his wife entered into a marital settlement agreement by which Reed transferred his interest in jointly held real property to his wife in exchange for transfer of her interest in his medical practice. Mejia challenged the MSA as a fraudulent transfer under the UFTA, claiming that the division of property was intended to hinder collection of future child support. She filed an action to obtain a lien against the real property. After litigation in the trial court, the Court of Appeal held that a property transfer under an MSA could be found to be invalid under the UFTA.

On appeal, the California Supreme Court recognized that “the UFTA permits defrauded creditors to reach property in the hands of a transferee,” while the Family Code “protects property transferred to a spouse incident to divorce from the debtor of the other spouse. In harmonizing these statutes, the Supreme Court determined that the UFTA on its face “applies to all transfers,” except “certain transfers resulting from lease terminations or lien enforcement,” and therefore “the UFTA on its face encompasses

transfers made under an MSA.” Id at 664. The Supreme Court noted that, as a consequence, “most decisions of other states construing parallel provisions of the UFTA hold that it does apply to marital property transfers, including those in connection with divorce.” The Supreme Court, “based on the policy considerations underlying the UFTA and the Family Code provisions governing dissolution judgments,” concluded that “the UFTA applies to property transfers under MSA’s.”

### Bankruptcy

A divorce may be followed by a debtor ex-spouse filing bankruptcy, particularly during these challenging pandemic times. Bankruptcy Code section 544 provides the bankruptcy trustee with the same rights that a creditor would under state law. Thus, the bankruptcy trustee can scrutinize an MSA and file suit challenging the MSA under California fraudulent transfer laws. The bankruptcy trustee can also bring actual and constructive fraud claims challenging an MSA under Bankruptcy Code section 548.

In defending an action in bankruptcy, consider that some courts allow a collateral attack defense regarding constructive fraudulent transfer claims. In *Batlan v. Bledsoe (In re Bledsoe)*, 569 F.3d 1106 (9th Cir. 2007), the 9th U.S. Circuit Court of Appeals affirmed dismissal of a Chapter 7 trustee’s constructive fraudulent transfer claim, holding that such claim was an improper attack on the state court’s dissolution judgment, which, following a regularly conducted contested proceeding, conclusively established “reasonably equivalent value” for purposes of Bankruptcy Code Section 548, absent actual fraud. In reaching its decision, the 9th Circuit relied on *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994) (holding that price received at a non-collusive foreclose

sale, properly conducted under applicable state law, conclusively established reasonably equivalent value). See also *Pryor v. Zerbo (In re Zerbo)*, 397 B.R. 642 (Bankr. E.D.N.Y. 2008); *In re Falk*, 98 B.R. 472 (D. Minn. 1989).

### Practical Considerations

*Mejia* demonstrates that MSA’s are subject to potential attack by creditors as fraudulent transfers under California law. They also may be attacked as such in an ex-spouse’s bankruptcy following divorce under the Bankruptcy Code Sections 544 and 548. Divorce attorneys and their clients would be well advised to keep fraudulent transfer laws in mind when addressing an MSA incident to divorce. Divorcing couples should avoid actual fraudulent transfers. In dividing property, consider and document the consideration being exchanged between the spouses, including any release of valuable claims. Finally, in the event of a subsequent bankruptcy and litigation over the MSA, consider a potential collateral attack defense to constructive fraudulent transfer claims among other possible defenses. ■

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