

Memorandum 2001-39

AB 873 (Harman): Estate Planning and Dissolution of Marriage

In September 1998, the Commission issued a recommendation relating to the *Effect of Dissolution of Marriage on Nonprobate Transfers*. In October 2000, the Commission issued a recommendation relating to *Estate Planning During Marital Dissolution*. Both of these recommendations would be implemented by AB 873 (Harman). Recent amendments to the bill are discussed below:

Life Insurance Exemption

On April 3, the bill was heard by the Assembly Judiciary Committee. During testimony a concern was raised regarding proposed Probate Code Section 5600, which provides that, absent clear and convincing evidence of a contrary intention on the part of a transferor, a nonprobate transfer to a spouse fails if the transferor and the spouse are no longer married at the time of the transferor's death. A member of the committee asserted that many low-income spouses who represent themselves in dissolution proceedings make informal agreements as to the disposition of their assets. In these agreements, which are often unmemorialized, it is common to preserve a former spouse's status as beneficiary of a life insurance policy in exchange for some other asset. Our proposed law would defeat such an agreement, by causing the failure of the designation of the former spouse as beneficiary.

The staff responded that this problem would only exist if an agreement is not memorialized, because a written agreement to preserve a beneficiary designation would fall within the exception for clear and convincing evidence of intent to preserve a nonprobate transfer to a former spouse. The staff also remarked that the risk that an agreement to preserve a nonprobate transfer to a former spouse will not be memorialized seems much lower than the risk that a divorcing person will want to revoke a transfer to a former spouse, but will inadvertently fail to take the necessary steps. The member who raised the concern disagreed and indicated that she would oppose the bill as drafted.

The author offered to exempt life insurance from the coverage of Section 5600. This change adequately addressed the concern raised and the change was made

as an author's amendment. The staff feels that the amendment was unfortunate, but not fatal to the policy of Section 5600. If the concern had been raised before the hearing, it might have been possible to reach a better compromise. However, at the time it seemed that the amendment was necessary to prevent opposition that could have threatened the bill.

The Comment to Section 5600 should be revised to read:

Comment. Subdivision (a) of Section 5600 establishes the general rule that a nonprobate transfer to a former spouse fails if, at the time of the transferor's death, the former spouse is not the transferor's surviving spouse. "Surviving spouse" is defined in Section 78. "Nonprobate transfer" does not include life insurance. See subdivision (e).

Paragraph (1) of subdivision (b) provides that a nonprobate transfer to a former spouse does not fail by operation of subdivision (a) if, at the time of the transferor's death, the nonprobate transfer is not subject to revocation by the transferor. This precludes operation of subdivision (a) where a nonprobate transfer is irrevocable on execution, or later becomes irrevocable by the transferor (for reasons other than the death or incapacity of the transferor). ~~For example, a court may order a spousal support obligor to maintain life insurance on behalf of a former spouse. See Fam. Code § 4360. If a person dies while subject to such an order, subdivision (a) would not affect the rights of the transferor's former spouse under the policy.~~ The irrevocability of a trust can be established by certification of the trust's contents. See Section 18100.5.

Paragraph (2) of subdivision (b) provides that a nonprobate transfer to a former spouse does not fail on the transferor's death if there is clear and convincing evidence that the transferor intended to preserve the nonprobate transfer. For example, if after divorcing, the transferor modified the beneficiary terms of a ~~life insurance policy~~ trust without changing the designation of the former spouse as primary beneficiary, this might be sufficiently clear and convincing evidence of the transferor's intent to preserve the nonprobate transfer to the former spouse so as to prevent the operation of subdivision (a).

Subdivision (c) governs the effect of failure of a nonprobate transfer under this section. For the effect of a failed nonprobate transfer of property, see Section 21111. For the effect of a failure of a trustee designation, see Section 15660.

Subdivision (d) makes clear that nothing in this section affects the rights of a good faith purchaser or encumbrancer for value who relies on the apparent failure of a nonprobate transfer under this section or who lacks knowledge of the failure of a nonprobate transfer under this section. For the purpose of this subdivision,

“knowledge” of the failure of a nonprobate transfer includes both actual knowledge and constructive knowledge through recordation of a judgment of dissolution or annulment or other relevant document. See Civ. Code § 1213 (recordation as constructive notice to subsequent purchasers and mortgagees). The rights of a subsequent purchaser or encumbrancer are also protected if the purchaser or encumbrancer relies on an affidavit or declaration executed under Section 5602. The remedy for a person injured by a transaction with a subsequent purchaser or encumbrancer for value is against the transacting former spouse and not against the purchaser or encumbrancer.

In general, Section 5003 protects a property holder from liability for transferring the property according to the terms of the instrument making the nonprobate transfer, even if the nonprobate transfer has failed by operation of subdivision (a).

This section may be preempted by federal laws with respect to employer-provided benefits. See ~~Metropolitan Life Ins. Co. v. Hanslip, 939 F.2d 904 (10th Cir. 1991) (ERISA preempts state law providing that dissolution of marriage revokes designation of former spouse as beneficiary to employer-provided life insurance).~~ See Egelhoff v. Egelhoff, 532 U.S. ____ (2001) (ERISA preempts state law revoking spouse’s rights as beneficiary of employer-provided life insurance). It is therefore especially important on dissolution or annulment of marriage to review beneficiary designations for employer-provided benefits.

The change in the last paragraph reflects a recent U.S. Supreme Court decision providing better authority for the proposition than the 10th Circuit decision previously cited.

Clarification of Form Warning Language

Prior to the bill being heard in the Assembly Judiciary Committee, committee staff suggested minor amendments to make the statutory form warning language in Family Code Section 2024 clearer. The Commission reviewed those suggestions and decided that further clarifying changes should be made. In consultation with the author’s office, committee staff, and the State Bar, the staff prepared amendments to implement the clarifying changes. The amendments have been submitted by the author and should take effect before the bill is next heard (in the Assembly Appropriations committee).

The amendments revise the warning language as follows:

“Dissolution or annulment of your marriage may automatically ~~change~~ cancel your spouse’s ~~right to such things as~~ rights under

~~your will, trust benefits, retirement death benefits benefit plan, power of attorney designation, pay on death bank accounts account, transfer on death vehicle registration, and survivorship rights to any property taken owned in joint tenancy, and any other similar thing. It does not automatically cancel your spouse's rights as beneficiary of your life insurance policy. If you do not want the dissolution or annulment of your marriage to interfere with the named beneficiary on these things, you must make that intention clear. Your rights to such things as~~ If these are not the results that you want, you must change your will, trust, account agreement, or other similar document to reflect your actual wishes.

Dissolution or annulment of your marriage may also automatically cancel your rights under your spouse's will, trust benefits, retirement death benefits benefit plan, power of attorney designation, pay on death bank accounts account, transfer on death vehicle registration, and survivorship rights to any property taken owned in joint tenancy may also be automatically changed upon dissolution or annulment of your marriage , and any other similar thing. It does not automatically cancel your rights as beneficiary of your spouse's life insurance policy.

You should review these matters, as well as any credit cards, other credit accounts, insurance policies, retirement benefit plans, and credit reports to determine whether they should be changed or whether you should take any other actions in view of the dissolution or annulment of your marriage, or your legal separation. However, some changes may require the agreement of your spouse or a court order (see Part 3 (commencing with Section 231) of Division 2 of the Family Code).''

Respectfully submitted,

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