

Memorandum 99-64

Effect of Dissolution of Marriage on Nonprobate Transfers: ATRO Issues

Family Code Section 2040 provides for an automatic temporary restraining order (ATRO) on service of the summons in a proceeding for dissolution or annulment of marriage, or legal separation. Except as necessary to pay attorney's fees or ordinary expenses, the ATRO restrains the parties from

transferring, encumbering, hypothecating, concealing, or in any way disposing of any property, real or personal, whether community, quasi-community, or separate, without the written consent of the other party or an order of the court....

The Commission has learned that this provision is not interpreted consistently by the courts. Some courts interpret the provision as restraining any change affecting the disposition of property, including the severance of a joint tenancy or modification of a nonprobate transfer (i.e., a transfer of property on death by means other than a will). Others apparently interpret the provision more narrowly. There appears to be no appellate decision on the matter. Inconsistent application of the ATRO could create problems and should probably be resolved.

The Commission instructed the staff to consult with representatives of the State Bar to determine how the inconsistency should be resolved. To that end, the staff met with Christopher M. Moore of the State Bar Family Law Section and Don Travers of the State Bar Estate Planning, Trust, and Probate Law Section. The meeting was very constructive, and the analysis set out below is based in large part on the contributions of Mr. Moore and Mr. Travers.

In determining the proper scope of the ATRO, we should consider the original intent behind the ATRO provision, the harms that could be caused by automatically restraining changes to a joint tenancy or nonprobate transfer, and the harms that could be caused if such changes were not automatically restrained. As it turns out, the answers to some of these questions depend on whether a nonprobate transfer is being revoked, modified, or created. Each of these types of transactions is discussed separately. A draft of legislation to implement the proposals made in this memorandum is attached as an exhibit.

LEGISLATIVE INTENT

The legislative history of the bill adding the ATRO provision indicates that its purpose was to conserve judicial resources by automatically imposing those types of restraints that were routinely sought and granted in dissolution proceedings. Unfortunately, there is nothing in the legislative history that indicates whether the ATRO was intended to apply to severance of a joint tenancy or modification of a nonprobate transfer. Nonetheless, it is helpful to keep the original goal of judicial efficiency in mind while analyzing the proper scope of the ATRO.

REVOCATION OF A NONPROBATE TRANSFER

Unintended Transfers

Automatic restraint of revocation of a nonprobate transfer and severance of a joint tenancy during a dissolution proceeding may create problems if one of the parties dies during the proceeding. If the restraint prevents that party from revoking a nonprobate transfer before death then the property will be transferred in an unintended way. Take two common examples:

(1) Husband and wife convey their community property into a trust that names the survivor of them as beneficiary and is unilaterally revocable by either. Wife files for dissolution of marriage and decides to revoke the trust so that husband will not receive all of the property if she dies during the proceeding. Before she can obtain a court order permitting revocation, she dies, and contrary to her wishes, husband receives the entire property.

(2) Husband and wife own a house together in joint tenancy. Wife files for dissolution of marriage and decides to sever the joint tenancy, so that husband will not receive the entire house if she dies during the proceeding. Before she can obtain a court order permitting severance, she dies, and contrary to her wishes, husband owns the entire house.

In each of these examples, the husband would not be deprived of any vested property interest if the wife were to revoke the nonprobate transfer during the proceeding. Husband's interest in a revocable future gift is a mere expectancy. This is analogous to revocation of a provision benefiting the husband in the wife's will — only an expectancy is terminated, not a vested property right. It appears that courts do not interpret the ATRO as restraining revocation of wills. The rule should probably be the same for will substitutes.

While it may be uncommon that an ATRO would prevent a person from revoking a nonprobate transfer before the person's death, there are four circumstances in which this could occur:

(1) The procedural delay involved in obtaining a court order results in the person's death before the order can be obtained.

(2) The cost and hassle associated with obtaining a court order convinces the person to defer the change until after the proceeding is completed.

(3) The person is unaware that the ATRO restrains revocation and makes the change without first obtaining a court order. In such a case, the transfer is probably ineffective. See Civ. Code § 2224 ("One who gains a thing by ... wrongful act, is ... an involuntary trustee of the thing gained, for the benefit of the person who would otherwise have had it."). Note that violation of the ATRO may be punishable as contempt. See Code Civ. Proc. § 1209(a)(5) (contempt includes disobedience of a lawful order of the court).

(4) The court could conclude that the requested action would be unjust and refuse to grant the requested order. See Code Civ. Proc. § 533 (court may modify a temporary restraining order to serve the ends of justice).

Regardless of how frequently these situations might arise, it is clear that there are circumstances in which effective revocation before death would be impeded by the ATRO, resulting in an unintended transfer.

Inefficiency

If parties to a dissolution routinely sever joint tenancies and revoke nonprobate transfers during the proceeding, then judicial efficiency is not served by automatically restraining those actions. It isn't clear how routine such actions are, but the court in one case concludes that family law attorneys *should* routinely sever marital joint tenancies. In *Estate of Blair*, one of the spouses died during a dissolution proceeding but before judgment. *Estate of Blair*, 199 Cal. App. 3d 161 (1988). Because the marriage had not yet been dissolved at the time of death, the common law presumption on death, that title controls the form of property, was applied (instead of the presumption on dissolution of marriage that property owned jointly by spouses is community property). As a result, the property was held to be joint tenancy and the survivor received the entire property. The court was unhappy with this result and stated (*id.* at 169):

We believe that applying the common law presumption in this type of case places an unnecessary legal task on the family law practitioner. The lawyer representing a party in a dissolution proceeding is now obligated to promptly partition all community property held in joint tenancy to avoid what occurred in this case.

This is consistent with advice given in a standard family law practice treatise. See Hogoboom & King, *California Practice Guide, Family Law* ¶¶ 1:367-369, 390, 394-394.1 (1999). The treatise describes the potential for an unintended transfer by operation of joint tenancy survivorship if one of the parties dies during a dissolution proceeding. *Id.* at ¶ 1:367. It maintains that it is the duty of family law attorneys to raise this issue with their clients and suggest immediate severance of any joint tenancy. *Id.* at ¶¶ 1:368-369, 390. However, the treatise cautions that severance of a joint tenancy “may well” violate the ATRO and that a party should therefore obtain either spousal consent or a court order before severing a joint tenancy. *Id.* at ¶ 1:394.1.

In light of the foregoing, it certainly appears that joint tenancy severance is a routine event in marital dissolution proceedings. By the same logic, revocation of a trust or other nonprobate transfer benefiting a spouse should also be common. Considering that careful attorneys will seek spousal consent or an order of the court before taking such actions, the court will be required to hear numerous requests that would probably be granted in most cases — an apparent waste of judicial resources.

Conclusion

As discussed, automatic restraint of severance of a joint tenancy and revocation of a nonprobate transfer may result in an unintended transfer. For this reason, it appears that competent attorneys would routinely advise severance of a joint tenancy and revocation of a nonprobate transfer during a dissolution proceeding (if not before). Because these changes do not affect vested property rights, they should be routinely approved by the court. Therefore, it does not seem fair or efficient to automatically restrain severance and revocation. **Section 2040 should probably be amended to provide that the ATRO does not apply to revocation of a nonprobate transfer or severance of a joint tenancy.** Note that this reflects the consensus reached at the meeting between staff and representatives of the State Bar. See attached draft of implementing language.

MODIFICATION OF A BENEFICIARY DESIGNATION

Effect on Community Property

Changing a beneficiary designation in an instrument making a nonprobate transfer may lead to an unauthorized transfer of community property. For example, husband maintains a pay-on-death bank account (POD account), funded with community property. During a dissolution proceeding he changes the beneficiary of the account from his wife to his friend. On his death, the friend withdraws the funds. Legally, the transfer of wife's share of the property can be set aside, because she did not consent to the modification of the beneficiary designation. See Prob. Code §§ 5021, 5023(b)(1). However, as a practical matter, it may be costly and difficult to recover the funds (especially if the friend is hard to locate, outside the state, or conceals or dissipates the funds). This problem is not posed by severance of a joint tenancy or revocation of a nonprobate transfer because those changes terminate the future donative transfer entirely.

The problem of an unauthorized transfer of community property is particularly acute for those types of transfers that operate on proof of the transferor's death, without administration by a trustee (e.g., POD accounts, Totten trusts, life insurance). See, e.g., Prob. Code §§ 5401 (POD account paid to payee on proof of death showing that payee survived all other named payees), 5405 (payment of POD account to surviving payee discharges financial institution from all claims for the amount paid, whether or not consistent with beneficial ownership of the account).

However, a frustrated desire to change a beneficiary designation carries the same risk of unintended transfer as a frustrated desire to revoke (discussed above). The question is which poses the greatest risk of harm: unintended transfer as a consequence of failure to modify a beneficiary designation before death, or an unauthorized transfer of community property to a third party, as a consequence of unrestrained freedom to make such changes during the dissolution proceeding. This is a difficult question, but the consensus at the staff meeting with the State Bar representatives was that beneficiary designation changes should be automatically restrained to protect against an unauthorized transfer of community property to a third party. It was felt that the burden associated with trying to recover community property transferred to a third party was substantially greater than the burden associated with obtaining a court order before modifying a beneficiary designation. Also, the party who wishes to change the beneficiary designation is in

position to act to implement that intention. The other party would probably be ignorant of the change until after the first party's death, at which time the only remedy is litigation. It therefore seems fairest and most efficient to impose the additional procedural cost on the party who wishes to make the change. For all of these reasons, **it probably makes sense to automatically restrain change of a beneficiary designation during a dissolution proceeding.** See attached draft of implementing language. Note that a rule permitting unilateral revocation, but requiring spousal consent to modify would be consistent with the statutory default rule governing community property trusts. See Fam. Code § 761(a).

Effect on Separate Property

The risk of an unauthorized transfer of community property is obviously not present where dealing with separate property. Thus, there seems to be no reason to restrain a party from changing a beneficiary designation in an instrument that transfers that party's separate property on death. For this reason, it may be appropriate to provide that the ATRO does not restrain a change of beneficiary of an instrument making a nonprobate transfer of separate property.

However, there will undoubtedly be cases where the proper characterization of property as separate or community will be in doubt (until decided by the court). If a party erroneously believes that an asset is separate property and changes the beneficiary designation in an instrument transferring that property on the party's death, then there is a risk of unauthorized transfer of community property (discussed above). The problem posed by a party's mischaracterization of an asset as separate property may be part of the reason that the ATRO currently restrains the disposition of both community and separate property. Of course, another possible reason for restraint of separate property changes might be the need to prevent concealment or dissipation of separate property that would otherwise be available in crafting a support order.

The staff is unsure whether the ATRO should restrain modification of a nonprobate transfer of separate property. However, for the sake of discussion, the attached draft legislation provides that such changes are not restrained.

CREATION OF A NONPROBATE TRANSFER

A person is apparently not restrained from making a new will during a dissolution proceeding. On general principles, the same rule should probably apply to will substitutes. What's more, if a party revokes a nonprobate transfer in

order to avoid an unintended transfer (as discussed above), and cannot then execute a new nonprobate transfer to dispose of the party's share of the property from the revoked nonprobate transfer, the property that would have been transferred will probably fall into the person's estate instead, where it would be subject to probate. Thus, automatic restraint of the creation of nonprobate transfers is inconsistent with the law of wills and may frustrate the transferor's desire to avoid probate. For these reasons, the ATRO should perhaps not restrain creation of a nonprobate transfer.

However, unrestrained creation of a nonprobate transfer may enable parties to circumvent the restraint on modification of beneficiary designations. For example, a party who is the holder of a POD account may revoke the POD status of the account and then create a new POD designation as a way of indirectly changing the beneficiary designation. The state bar representatives feel that the potential for indirect modification of a nonprobate transfer is a significant problem. **For the purposes of discussion, the attached draft language provides that the ATRO restrains creation of a nonprobate transfer.**

Because the harm at issue is an unauthorized transfer of community property, the question of whether to restrain *separate property* transfers (discussed above) arises here as well.

LIFE INSURANCE — A SPECIAL CASE

The ATRO expressly restrains cancellation or modification of any type of insurance during a dissolution proceeding. This preserves the status quo in important ways — such as preventing the removal of a spouse or children from health insurance coverage. It also helps avoid the problem of an unauthorized transfer of community property to a third party, discussed above. Finally, it provides an asset that the court can use in fashioning a support order (it is fairly common for one spouse to be ordered to maintain life insurance for the benefit of the other spouse). **For all of these reasons, the present restraint on cancellation or modification of insurance policies should probably be preserved.**

RECIPROCITY AND RETROACTIVITY

One problem with existing law is that the ATRO only operates to restrain changes after service of the summons. This means that the petitioner is free to make any changes desired before filing for dissolution. In such a case, only the

respondent is meaningfully restrained. The potential unfairness of this situation could be minimized by retroactively voiding actions of the types restrained by the ATRO that were taken during some fixed period before service of the summons, perhaps 90 days. If this approach were taken, a party should be able to avoid the retroactive voiding of a transaction by obtaining ratification of the transaction after the fact, either by obtaining the spousal consent or an order of the court. This approach is similar to the preferences rule in a bankruptcy proceeding, which allows a trustee to void transfers of property from a debtor to the debtor's creditors that occurred within 90 days of filing of the petition. See 11 U.S.C. § 547(b).

On the other hand, this approach would complicate the law significantly in order to avoid a relatively rare problem — where petitioner makes a change that would be restrained under the ATRO before filing, and respondent would like to make a similar change, but is impeded by the ATRO from doing so before dying. Furthermore, retroactive voiding seems counterintuitive and would probably come as a surprise to many petitioners who would believe that they had taken care of desired estate plan changes when in fact they had not. **The staff does not favor this approach.**

CONCLUSION

The attached draft legislation would provide that the ATRO restrains creation and modification of a nonprobate transfer of community property, but does not restrain creation or modification of a nonprobate transfer of separate property, severance of a joint tenancy, or revocation of a nonprobate transfer (other than life insurance). This is a somewhat complex resolution of the matter, but may best serve the goal of efficiency and the respective rights of the parties. The Commission should consider whether to prepare a tentative recommendation on the matter, along the lines discussed in this memorandum.

Respectfully submitted,

Brian Hebert
Staff Counsel

Exhibit

Effect of Dissolution of Marriage on Nonprobate Transfer: ATRO Issues

PROPOSED LEGISLATION

Fam. Code § 2040 (amended). Automatic temporary restraining order

SECTION 1. Section 2040 of the Family Code is amended to read:

2040. (a) In addition to the contents required by Section 412.20 of the Code of Civil Procedure, the summons shall contain a temporary restraining order:

(1) Restraining both parties from removing the minor child or children of the parties, if any, from the state without the prior written consent of the other party or an order of the court.

(2) Restraining both parties from transferring, encumbering, hypothecating, concealing, or in any way disposing of any property, real or personal, whether community, quasi-community, or separate, without the written consent of the other party or an order of the court, except in the usual course of business or for the necessities of life and requiring each party to notify the other party of any proposed extraordinary expenditures at least five business days before incurring those expenditures and to account to the court for all extraordinary expenditures made after service of the summons on that party.

Notwithstanding the foregoing, nothing in the restraining order shall preclude a party from using community property, quasi-community property, or the party's own separate property to pay reasonable attorney's fees and costs in order to retain legal counsel in the proceeding. A party who uses community property or quasi-community property to pay his or her attorney's retainer for fees and costs under this provision shall account to the community for the use of the property. A party who uses other property that is subsequently determined to be the separate property of the other party to pay his or her attorney's retainer for fees and costs under this provision shall account to the other party for the use of the property.

(3) Restraining both parties from cashing, borrowing against, canceling, transferring, disposing of, or changing the beneficiaries of any insurance or other coverage, including life, health, automobile, and disability held for the benefit of the parties and their child or children for whom support may be ordered.

(4) Restraining the creation or modification of a provision making a nonprobate transfer of community property on the transferor's death, without the written consent of the other party or an order of the court. Except as provided in paragraph (3), nothing in this section restrains the creation or modification of a provision making a nonprobate transfer of separate property, revocation of a provision

1 making a nonprobate transfer of community or separate property, or severance of a
2 joint tenancy.

3 (b) In all actions filed on and after January 1, 1995, the summons shall contain
4 the following notice:

5 “WARNING: California law provides that, for purposes of division of property
6 upon dissolution of marriage or legal separation, property acquired by the parties
7 during marriage in joint form is presumed to be community property. If either
8 party to this action should die before the jointly held community property is
9 divided, the language of how title is held in the deed (i.e., joint tenancy, tenants in
10 common, or community property) will be controlling and not the community
11 property presumption. You should consult your attorney if you want the
12 community property presumption to be written into the recorded title to the
13 property.”

14 **Comment.** Section 2040 is amended to clarify the scope of the automatic temporary restraining
15 order (ATRO) with respect to changes affecting a nonprobate transfer of property on death. See
16 subdivision (a)(4). See also Prob. Code § 5000 (nonprobate transfers).

17 The fact that the ATRO may not restrain modification or revocation of a nonprobate transfer
18 does not mean that the nonprobate transfer is subject to modification or revocation by a party. The
19 question of whether a nonprobate transfer is subject to modification or revocation is governed by
20 the terms of the instrument and applicable substantive law.

21 Note that the court may order a restraint on changes to a nonprobate transfer or severance of a
22 joint tenancy on the motion of a party. See Section 2045.

23 **Fam. Code § 2045 (amended). Ex parte protective and restraining orders**

24 SEC. 2. Section 2045 of the Family Code is amended to read:

25 2045. During the pendency of the proceeding, on application of a party in the
26 manner provided by Part 4 (commencing with Section 240) of Division 2, the
27 court may issue ex parte any of the following orders:

28 (a) An order restraining any person from transferring, encumbering,
29 hypothecating, concealing, or in any way disposing of any property, real or
30 personal, whether community, quasi-community, or separate, except in the usual
31 course of business or for the necessities of life, and if the order is directed against
32 a party, requiring that party to notify the other party of any proposed extraordinary
33 expenditures and to account to the court for all extraordinary expenditures.

34 (b) A protective order, as defined in Section 6218, and any other order as
35 provided in Article 1 (commencing with Section 6320) of Chapter 2 of Part 4 of
36 Division 10.

37 (c) An order restraining a party from creating, modifying, or revoking a
38 nonprobate transfer, or severing a joint tenancy.

39 **Comment.** Section 2045 is amended to authorize issuance of a court order restraining certain
40 changes to a nonprobate transfer that may not be automatically restrained pursuant to Section
41 2040. See Section 2040(a)(4).