
Family Business Report

1999-05-01

Prenuptial Agreements: Promoting or Undermining Sound Family Relations and Sound Family Businesses?

Introduction

Frequently couples contemplating marriage are urged by other family members to negotiate a prenuptial agreement. Nevertheless, misconceptions with respect to the purposes and effects of such agreements are widespread. Furthermore, relations between the parties' respective families may be damaged if negotiation of such an agreement is handled indelicately, particularly if the agreement is viewed by the family of one party as an expression of disapproval of the other party.

Couples contemplating such a prenuptial agreement and their professional advisors should therefore consider: (1) the purposes and benefits of such agreements; (2) the means by which such agreements may be negotiated to protect the financial interests of each party, and to promote their mutual interests in strengthening their relationship with each other and with their respective families; and (3) the effects of such agreements on ownership interests in family firms.

Limited Purposes of Prenuptial Agreements

A prenuptial agreement has the limited function of protecting each party's interests in his or her own property and in defining each party's rights to the property of the other. Accordingly, such an agreement will deal with the property rights of each party if the marriage is terminated by death or divorce.

For example, under the laws of most (if not all) states, if a husband or wife dies and the surviving spouse is dissatisfied with the provisions which the decedent made for him or her, the survivor may instead elect to take a share determined by statute. The statutory share may be as large as one-third of the decedent's estate. Therefore, if the surviving spouse were to take such a share, he or she could undermine materially the decedent's estate plan, including plans for disposition of interests in a family business.

Under a prenuptial agreement, the parties often agree that each will relinquish the right to take a statutory share of the other's estate and will accept instead a specified amount of property or

income to be paid from the decedent's estate. Each party may then plan with certainty for the disposition of the balance of his or her property, including family business interests, whether acquired before or after the marriage takes place.

Similarly, the agreement also should specify the property rights and obligations of each party in connection with divorce. Such an arrangement may avoid a lengthy, expensive and potentially acrimonious negotiation of such rights if the marriage proves unsuccessful. Furthermore, the agreement may also ensure financial security to the less wealthy party, but permit the more wealthy party to rely on protection of his or her remaining assets from any claims arising from divorce.

Enforceability of Prenuptial Agreements

Although the standards for enforcing prenuptial agreements may vary from state to state, in almost all states four conditions are imposed.

First, each party must make complete disclosure to the other of his or her assets, liabilities, sources of income, and any other facts likely to affect his or her financial position.

Second, each party must be represented by separate and independent legal counsel (or must make a voluntary and well considered decision to waive such independent legal counsel).

Third, the terms of the agreement must be "fair" at the time the agreement is entered into, a standard with respect to which even reasonable people may differ. Furthermore, in some states, the effect of the agreement must also be fair at the time the agreement is enforced, typically upon termination of the marriage by death or divorce.

Finally, the agreement may be set aside by the courts if enforcement of the agreement would impoverish either party and thereby create a risk that either party (or any minor children of either party) would require public assistance.

The Effect of Prenuptial Agreements on Family Relationships: The Second (or Subsequent) Marriage

Prenuptial agreements are far less likely to damage relationships between the parties (or between their respective families) when they are negotiated on behalf of older parties, each of whom has children from a prior marriage. Each party has a legitimate interest in protecting the rights of his or her children to inherit his or her estate. Furthermore, in the context of a family business, each party may have obvious and legitimate loyalties to other family members who hold stock or other ownership interests in the family firm. Protecting such rights does not imply that either party's family disapproves of the other party.

Once the parties recognize that each has a legitimate interest in preserving assets to be inherited by his or her children, or in preserving family control over the family business after he or she dies, the parties should also recognize that each party's children have an interest in ensuring that their parent's resources will not be depleted, and that interests in the family firm will not pass outside the family, if the marriage fails.

Finally, negotiation of such an agreement may strengthen the relationship between the parties by giving each party assurance that his or her property rights are protected, including his or her rights to transfer family business interests and other assets to children or other beneficiaries upon death, and by avoiding any misunderstanding by either party of the other party's intentions and expectations.

The First Marriage

A more difficult case arises when such a prenuptial agreement is negotiated between two parties, neither of whom has been married before, or neither of whom has children or any other third parties to whom any obligations may be owed. Furthermore, in such a case, the agreement is often negotiated at the suggestion (or behest) of parents who wish to diminish any financial risk incurred by their child as a result of his or her marriage and to protect any family business interests the child might ever acquire.

It is particularly in this context that either family's suggestion to create such an agreement could be construed as evidence of distrust or hostility. In that case, what substantive suggestions may be made by the lawyer for either party to minimize the potential that the agreement would create needless ill will between the parties' respective families?

One option, which has been adopted with increasing frequency, is to limit the scope of the agreement so that it protects only (1) the assets which each party owns on the date of the marriage; (2) any assets which either party may thereafter acquire by gift or inheritance; and (3) interests in family businesses, no matter when or by what means such interests are acquired, (e.g., if such interests are not received as a result of a gift or inheritance, but instead are purchased by one of the parties from other family members).

Such an agreement may provide substantial protection with respect to precisely those assets acquired by one party without any effort on the part of, or any contribution from, the other party. Furthermore, such protections recognize the legitimate interests of each party's parents in making gifts or bequests intended solely to benefit their own child and to ensure continuing family control over the family firm.

On the other hand, the obvious disadvantage to such an agreement is that it leaves unprotected other assets which may be of substantial value, and disposition of such assets may be difficult to negotiate in any subsequent divorce.

A second alternative, employed less frequently, is creation of a family compact or agreement which has moral suasion but typically is not legally enforceable. Ideally, such a family agreement would be written before any of the children has found a prospective spouse. All of the children and the parents would then agree that, if any of them should thereafter marry (or, in the case of the parents, if either of them should thereafter remarry), each of them will attempt to negotiate a prenuptial agreement protecting his or her assets (or at least the three limited classes of assets described above) from the claims of any prospective spouse. The clear advantage of such an arrangement is to dispel the implication that a subsequent request to negotiate a prenuptial agreement is an expression of dissatisfaction with any particular child's future spouse.

A third alternative is to include in the prenuptial agreement a so-called "sunset" provision, under which the terms of the agreement lapse after a specified period of time (e.g., five or ten years after the marriage takes place). Such sunset provisions are more prevalent when the agreement is intended to protect property other than the three limited classes of assets described above. Such an agreement may enhance relations between the parties because, in the event of a reasonably lengthy marriage, neither party's financial best interests would be undermined by limiting his or her interests in the assets accumulated by the other party during their marriage.

The Role of the Lawyer

Unlike other professional advisors to the family, who may have a proper professional interest in maintaining neutrality and in promoting harmonious relations among all the parties, the lawyer is compelled, under the ethical obligations of the legal profession, to represent solely the interests of his or her client, and to provide to the client unequivocal and undivided loyalty. The lawyer must therefore consider first the client's financial best interests.

Nevertheless, in the context of a prenuptial agreement, the lawyer serves as negotiator and counsellor, not as a champion hired to attack a hostile adversary. It is therefore consistent with the lawyer's ethical obligations to devise arrangements which maintain the client's strong relationship with the other party and avoid needless discord in the relations between the parties' respective families. The results are beneficial to both parties if the lawyer has crafted an agreement which promotes simultaneously the client's need for financial security and both parties' desire for a happy and enduring marriage.

Michael L. Fay
michael.fay@haledorr.com

Family Dynamics

Ten Pointers

Families (like other groups) have personalities.

1. Personalities are a factor in every business, but in a family business this factor often swamps business planning and business management and costs a fortune.
2. One-by-one we each have personalities. We send out our own special message (like a distinctive bird call) to every other person we meet, and we translate their messages to us into our own special idiom. Not only individuals, but also families (like other groups), have personalities.
3. Like *Mutt and Jeff*, or the *Katzenjammer Kids*, or the cast of *Seinfeld* or *Are You Being Served?*, specific members of the family seem always to be assigned to play a special role, quite predictably. We almost know what they are going to say or do. Sometimes it's

funny, sometimes it's not.

4. The expression, "family dynamics," refers to the predictable way in which members of a family play their defined roles opposite each other. The expression, "family system," refers to the same thing, but emphasizes that something mechanical or systematic is going on, repeatedly or consistently. The family members, doing their predictable things, are like characters in a sitcom.
5. When we do things predictably, enacting a script, things which seem like part of a plot, we may be asked, "Why do you do that?" We often have a plausible answer (rather than candidly say, "I don't know"). Some people don't believe the answer. Sometimes, the better the answer is, the more they don't believe it. Will Rogers would say, "The more you explain it, the more I don't understand it."
"Rationalization," is the label for these facile and unconvincing answers. The concept of rationalization is connected with hypnosis.
6. Hypnosis was a 19th century parlor trick associated with Franz Mesmer's (1734-1815) bogus theory of "animal magnetism." For a time it was a mere unscientific parlor trick, but it had enormous impact on the history of science. The hypnotist would cast his subject into a trance, and, among other tricks, would say to the subject that he would wake up on command and forget everything which had happened, but that whenever the hypnotist later said the word, "Evening," the subject would take out his pocket watch, look at it, and give it a shake.
Sure enough, upon command the subject awoke from the trance, serenely oblivious of the tricks he had just been made to do. Having been thanked for his assistance, he began to leave the stage when the hypnotist casually wished him, "Good Evening." The subject then promptly took out his pocket watch, looked at it, and gave it a shake. The audience would laugh.
Sigmund Freud, in 1900, noted that the hypnotist's subject, when asked why he took out his watch, looked at it, and gave it a shake, would always have a plausible but false explanation. This plausible but false explanation of behavior which obeyed an unconscious force Freud called "rationalization."
7. Rationalization is our effort to give a plausible explanation of our behavior, even when we don't know why we did it; the behavior is attributable to influences outside our awareness or memory.
8. The lawyer or other counselor who advises a family business often finds that his or her good, sound and well-reasoned advice is frustrated by the irrational and perverse attitudes and behaviors of individuals in the family, or of the whole family. The advice may lead to hostility towards the counselor. No amount of legal work will get to the bottom of it. The pattern is rigid and predestined, like a farce, a tragedy or a sinister melodrama. Yet if the counselor asks the individuals, or the whole family, why they act like that, they always have

a plausible answer.

"Family Dynamics" or "Family Systems" theory is an effort to understand what is behind the rigidly predetermined maladaptive family behavior. The presupposition is that the irrational behavior is explainable and makes sense, like the behavior of the subject obeying a post-hypnotic suggestion. The players may be in the position of the hypnotic subject who does not know why he takes out his pocket watch, looks at it, and gives it a shake.

9. Usually, the family business counselor does not know the answers either: "Every time this one says, 'Good Evening,' that one takes out his pocket watch, looks at it and gives it a shake: -- I don't understand," says the counselor.
10. In the family business case, there is no parlor trick in the background, but there is a long family history which is. Between child and parent there is something like the ritual of hypnotic trance: a history of rapt mutual gazing, intent listening, soothing contact and timeless intervals.

Also there are awakenings, such as the intrusion of a brother or sister. The intruder is perhaps best dealt with by ignoring and forgetting. This is something like the hypnotic subject's obliviousness.

Recognizing Good Advice In Family Business Conflicts

A lawyer or other counselor engaged by a family in business together -- who have conflicts recognized as such, or who are stalled by conflicts which are not called by that name -- may never know whether his or her advice is any good. A client may have good feelings about bad advice, or bad feelings about good advice; the client's feelings are not conclusive, therefore.

Is the outcome the test? Sometimes nothing happens; there is no improvement. That suggests that the counselor's intervention was ineffective (it may not have been bad, but it was ineffective). Even so, however, one can judge that "nothing has happened" only by artificially creating a time frame, saying that such and such a time and date was the end of the test. Then one can conclude that, within that time frame, nothing good happened. The true story, however, has no beginning and no end; we may be dead before something happens.

Then, again, there may be an improvement. It may happen while we're still alive and watching, possibly before it's too late. There may be no consensus, however, that our advice ever had anything to do with the improvement.

It seems fairly likely, in fact, that an intervention which mobilizes the family business stand-off will cause some discomfort (possibly a genuine pain), simply because the conflict or impasse served an important and carefully guarded set of needs or wishes. Anyone who disrupts it threatens losses and frustrations, which will usually be viewed as disastrous (unless the counselor's ability to calm the participants is adequate). Nothing works, by definition, unless the family business participants -- not the lawyer or other counselor -- start to do something differently with each other, and without the

counselor's pulling the strings. Grateful attribution of the improvement to the counselor, therefore, is not to be expected; on the contrary, it is suspect.

The counselor's intervention is viewed in retrospect as nothing but a little nudge.

It can happen that the family in business will forget all about the counselor, themselves solve the problems which brought them in for advice, and go forward on their own to more and better business. They may possibly make some parting shot in the way of thanks to the counselor, but that may be the end of it. This outcome is the one most likely to be a talisman of a successful intervention. The family were stuck -- no doubt about it -- and now they're unstuck -- no doubt about that, either. There may be nothing to explain the change except the counselor's intervention (viewed in retrospect as nothing but a little nudge). After that event came some practical use of good sense, not by the counselor (who knows nothing at all about such things) but by the family in business.

Thus, recognizing good advice, both for the getter and for the giver of the advice, is not so easy.

How does one choose an advisor, then? It's not so much in the clever advice-giving, as it is in the patient taking in and containment of what the family in business are saying and doing together (undamaged by any unfriendly surprises which are ostensibly directed to the counselor). Also, there are the specific abilities to notice gaps and reversals, what they are not saying and not doing, and the love in the family hate, the hate in the family love. Like Santa at Christmas midnight, the good advisor gets all the thousands of parts out of the box, lays them out carefully, cherishes and studies them slowly, ponders how they might have craftily been designed to fit together, and then says something (maybe something dumb, after all) which seems observant and elicits self-observation which is truer. It will be some other participant who actually finds the fit, in the end.

Louis H. Hamel, Jr.

louis.hamel@haledorr.com

Authors

Martin S. Kaplan

RETIRED PARTNER

☎ +1 617 526 6000