A Better Prenuptial agreement: Premarital Agreements Reimaged as Partnership Agreements

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Introduction: Premarital Agreements are Here to Stay—Why not Make Them Better?

Nationwide, premarital agreements are on the rise.[1] A 2015 survey of the Northern California Chapter of the American Academy of Matrimonial Lawyers reveals that California is no exception to this trend.[2] A surprisingly robust number of practitioners surveyed— 77%—routinely include premarital agreements as a part of their practice.[3] Among practitioners who included premarital agreements as part of their practice over the past ten years, a majority are now doing *more* than ever before.[4]

Referring to this data as "surprising" reveals my own preconceptions prior to conducting the survey. Although currently I am drafting, reviewing, and mediating more premarital agreements than in years past, I expected to find few responders drafting these agreements, with a declining as opposed to rising trend. This is clearly not the case. I believe my mistaken expectation is a result of the fact that the voices opposing premarital agreements, among both our colleagues and the general public, are often louder and more insistent than the supporters'.

Survey respondents who do *not* include premarital agreements as part of their practice recited a list of concerns, chief among them a distaste for the concept of premarital agreements (some referred to them as "nothing more than divorce planning instruments"), and a fear of being sued years later for damages that could eclipse the fees collected for the original premarital agreement.

Premarital agreements don't just have a bad reputation among lawyers. There continues to be a stigma in the media associated with such agreements. In the 2014 movie *Gone Girl*, for example, a bitter husband stores his copy of a premarital agreement in a "box of hate," nestled among letters he found between his wife and her ex-boyfriend and the expiration notice for his fertility materials.

I argue here that, since premarital agreements are here to stay, they can actually be *good* or, at the very least, better if we re-examine the way that they are crafted, not only substantively but also procedurally. The better premarital agreement educates couples about the legal rules on the front end, and informs them, through the disclosure process, about their respective finances. The better premarital agreement enables couples to have a meaningful discussion with their partners about their goals and interests and how best to achieve them. It empowers them to customize the rules regarding their finances during the intact marriage as well as upon death or divorce. The better premarital agreement, by no means a panacea to divorce, sets the stage for successful conflict resolution and compromise.

Marriage as a Going Concern: The Operating Agreement Model Applied to Premarital Agreements

Getting married is one of the most profound financial decisions a person can make. The acts of joining assets and income and taking on joint liability for another's actions can have significant impact. While premarital agreements may be on the rise, the vast majority of married couples, over 90% according to one authority, still get married without one. [5] As such, they get married without having an explicit mutual understanding about their financial situation, goals, and expectations. Instead, they confidently (and all-too-often naively) rely upon the "trustworthiness" of their spouse and

their belief that future problems will be handled "fairly." We have all seen the devastation that can occur when parties wait until the end of their marriage to talk about what financial arrangement each thinks is fair.

The better premarital agreement does not focus solely on the protection of a single spouse's financial interests as imagined from the rearview mirror of divorce planning. The better premarital agreement looks instead like a joint plan, based on the mutual goals and interests of prospective financial partners; an operating agreement that is the product of mutual goal setting and financial planning to achieve those goals.

According to the United States Small Business Association (SBA), parties entering into any business relationship are well advised to form an operating agreement for three reasons: 1) to protect their personal liability, 2) to clarify verbal agreements, and 3) to ensure that the agreements between the parties are legally enforceable in the event that the business dissolves. As the SBA website explains, "[s]tate default rules govern LLCs without an official operating agreement. This means that each state outlines default rules that apply to businesses that do not sign operating agreements. Because the state default rules are so general, it is not a good idea to rely on them for your agreement."[6]

The rationale for having a business operating agreement applies with equal force in the marriage context. When advising a client about whether or not he or she "needs" a premarital agreement, I often point out that the California Family Code ("FC") imposes a "premarital agreement" on you whether you know about it or not. The important thing is to understand the default rules and how they would apply to you, test them against your own values, goals, and interests and, if they fail to match, pursue a premarital agreement so that the rules governing marriage reflect the couple's mutual desires rather than the presumptions of the legislature.

Returning to the SBA's model, there are three over-arching topics that the SBA recommends be addressed in any operating agreement. [7] First, to determine **who owns what,** an operating agreement should address the percentage of membership ownership and distribution of profits and losses. Next, the operating agreement should govern **how the business is to be operated,** including voting rights and responsibilities, powers and duties of members and managers, and holding meetings to discuss and resolve issues as they arise. Finally, an operating agreement should address "**Buy-Out" and "Buy-Sell Provisions**," including provisions for voluntary dissolution of the business and procedures for transferring a member's interest if there is a death during the term of the business.

The vast majority of premarital agreements today, unlike the SBA model, devote the bulk of their pages to what happens upon divorce——the "voluntary" dissolution of the partnership——including a great many boilerplate provisions aimed at strengthening the enforceability of the agreement in anticipation of a challenge in a court setting. At most, they include just a paragraph or two on how the business of the marriage is to be conducted while the parties are happily married, and what would happen if the marriage ends upon death. The better premarital agreement gives equal if not greater focus to operating topics as well.

Who Owns What?

In a business operating agreement, the prospective business partners must determine who is to contribute what to the business, both in terms of labor and capital, and how to split the income and liabilities of the business over time.

While most California premarital agreements do a fairly good job identifying the character of assets going into the marriage, as well as the character of the income to be earned during marriage and debts that may be incurred, in my experience this is usually an all-or-nothing proposition. Many times the separate property brought into marriage is identified and permitted to grow unshackled by the specter of apportionment pursuant to the *Pereira/Van Camp/Beam* line of cases, while the income and debts accrued during the marriage are either also kept wholly separate or are shared fifty-fifty. Only very rarely have I seen people attempt to enter into an agreement that customizes the percentages *between* the two extremes of zero and fifty-fifty.

This "all or nothing" approach to marital property and income is actually a minority[8] view, although I would hazard a guess that few of us present it this way to our clients. The majority of states have elected the equitable distribution statutory scheme, in which much more discretion is awarded to the courts and the parties to divide their marital property, at least in the divorce context. "Most states follow equitable distribution laws. In these states, property acquired during the marriage belongs to the spouse who earned it. In case of divorce, the property will be divided between the spouses in a fair and equitable manner. There is no set rule determining who receives what or how much; the court considers a variety of factors. For example, the court may look at the relative earning contributions of the spouses, the value of one spouse staying at home or raising the children, and the earning potential of each. *A spouse can receive between one-third and two-thirds of the marital property.*"[9] In a mobile society in which there is always at least a chance that the couple will move out of California at some point during the marriage, it is imperative that family law advisors not only advise clients of the California rules, but also let them know that they have choices.

In a business partnership agreement, it would not be uncommon for one partner to be assigned, for example, 75% of the income, and the other 25%, in recognition not only of differing assets and skills that each contributes to the partnership, but also the different roles that will be performed in the ongoing business by each partner. Likewise, in a prenuptial agreement, it is possible to allocate assets, income, and liabilities in creative ways, such as:

- An ownership percentage between zero or fifty-fifty, perhaps depending on factors such as premarital wealth, the expectation of inheritance, earning capacity, or the likelihood that time will be spent out of the workplace for raising children.
- Different ownership percentages for different categories of assets. For example, wage and salary income might be

fifty-fifty, while other categories (perhaps new businesses or intellectual property assets) would be 60% the separate property of the operating spouse or the inventor, and 40% belonging to the other spouse.

- A vesting schedule in which assets either begin as the separate property of each spouse, and "vest" over time so that ultimately they become entirely community property, or alternatively, are transmuted upon marriage to community property but remain subject to a FC section 2640 right of reimbursement that diminishes ratably over time on divorce. This type of structure would also enable the spouses to take advantage of the special tax treatment of community property on death.[10]

In sum, family law practitioners should dare to engage in a deeper discussion with their clients about how assets, debts, and income are to be owned, rather than confining the discussion to the all-or-nothing approach of what is to be "separate," and what is to be fully fifty-fifty.

How is the Business to Be Operated?

In a business operating agreement, it is standard to include provisions about the voting powers and managerial responsibilities of each of the prospective partners. In the marriage context, provisions about the operation of the business can be broken down into two sets of issues——the first being the practical, logistical issues of managing the couple's financial affairs, and the second dealing with the ability of spouses to alter their fiduciary relationship with one another during the ongoing marriage in terms of management and control.

Although today's premarital agreements discuss the allocation of income and liabilities during the marriage, this is almost always addressed from the rear-view perspective of divorce. Income will be identified as community property, but there are often few words in the agreement about where that income will reside, who will have the ability to withdraw/invest, etc. As for liabilities, again there may be a few provisions reiterating community debt presumptions, but premarital agreements usually do not contain topics such as the ability of one spouse to undertake financially risky business endeavors or engage in debt financing. Most, if not all, couples would benefit from a discussion with a financial advisor so they can begin to understand one another's risk tolerance, and at least anticipate making a financial plan. This discussion could include other logistical details regarding how certain expenses are to be paid, plans for saving for retirement, and the needs of children and elderly parents, for example, and these terms then become an important part of the better prenuptial agreement.

In discussing the ongoing management of the partnership of marriage, another important set of issues concerns the fiduciary duties owed between spouses. California has a long tradition of fiduciary duties that bind spouses, as codified in FC section 720 *et seq.* FC section 721(b), which states that "this confidential relationship is a fiduciary relationship subject to the same rights and duties of non-marital business partners, as provided in sections 16403, 16404 and 16503 of the Corporations Code…" These duties include providing each spouse with a right of access to books and records, providing information upon request concerning community property transactions, and accounting to the other spouse and holding as a trustee any benefits that concern community property.

These fiduciary duties, not all of which are totally intuitive to a layperson, should be reviewed in detail with couples so they have this information from the very beginning and can tailor these duties to their own needs and interests, to the extent permissible by law.

Certain fiduciary duties are probably not waivable as a matter of public policy. These would include, for example, eliminating the obligation of good faith and fair dealing and/or the duty of loyalty, and unreasonably restricting the right of access to information and records, as well as the duty of care.[11] However, this does not mean the topic of management and control is utterly taboo. FC section 1612(a)(5) provides that a premarital agreement may address "personal rights and obligations, not in violation of public policy or a statute imposing a criminal penalty." Dawn Gray and Steve Wagner posit in their legal treatise on fiduciary duties that it should be possible to include a provision narrowing and clarifying certain management and control rights, provided this is done carefully. As the authors explain, "it would appear that spouses-to-be, like partners-to-be, may be permitted to make some modifications to the duty of disclosure, duty of loyalty and duty of care, which can take place in premarital agreements if Corporations Code Section 16103 is deemed applicable to the negotiation and execution of premarital agreements."[12]

By way of example, if the parties wish to enter into an agreement that strengthens the independence of the separate property owners, they might wish to include provisions releasing the parties from the obligation to inform one another of prospective business or investment opportunities, as well as eliminating the obligation to allow the *other* party to either co-invest from his/her separate property or to offer the opportunity to the community first, before the separate property spouse takes advantage of it themselves. To my knowledge, there are no reported cases at present specifically upholding such a provision in a premarital agreement. However, spouses already have some freedom when it comes to the reasonable management and control of their separate assets.[13] *In re Marriage of Connolly,* the court stated "[w]e have repeatedly held that parties may elect to deal with each other at arms' length, and when they do so any fiduciary obligation otherwise owing is thereby terminated."[14]

What about Termination Provisions?

As mentioned above, the one operating agreement topic that is thoroughly addressed in almost all premarital agreements is what happens on divorce. Notwithstanding the fact that marriages are equally, if not more likely, to end with the death of one of the spouses rather than on divorce, many practitioners advise their clients not to include any death provisions at all or, worse yet, routinely include a provision that eradicates the probate code protections for spouses. The better prenuptial agreement, ideally prepared with the expert

assistance of estate planning counsel, squarely addresses the death issue.

Contracts to make a will, including provisions in a premarital agreement for gifts on death, are enforceable in the State of California.[15] Interestingly, while family law attorneys are busy trying to avoid these provisions, the majority of my clients are, if not eager, at least comfortable including this as a part of the agreement. Sometimes this is a place in the agreement where a party feels he or she can be generous—even with assets that are carefully segregated during life and on divorce. On the other end of the spectrum, there are those clients whose sole purpose in entering into a premarital agreement is to pave a smooth way for other heirs, children from a prior marriage for example, to inherit in lieu of the surviving spouse. Planning for what happens on death, whether that takes the form of an acknowledgment that there will be no inheritance at all, or a promise to make a particular gift or provision for the spouse's benefit, can be an important component of the couple's premarital agreement.

It is particularly important to include these types of provisions if, upon interviewing the client, it appears that promises relating to the estate plan have already been made and relied on. For example, on several occasions clients have told me they are comfortable waiving community property *because* they have been promised that a house or a specified amount of money is being left for them on the other person's death. This is an important deal point and should be an express part of the better premarital agreement. To ensure that these at-death promises are enforceable, a specific reference to them should be contained within the premarital agreement itself, thus ensuring that these provisions cannot be changed without both parties' knowledge and consent. However, this does not mean that family law attorneys should be drafting this language themselves. I strongly encourage family law practitioners to seek the input of estate planning lawyers when attempting to include "at death" provisions to avoid potential tax and ambiguity issues.

A second area to be mindful of when preparing the better prenuptial agreement is the waiver of family protections on death that are normally available to spouses under the Probate Code. These include the right to a probate homestead, a family allowance, and protections for omitted spouses, among other rights. It has become increasingly common practice for premarital agreements to simply waive all of these protections. While in some circumstances this may be entirely appropriate, in most cases it is not. These protections, designed by the legislature to provide financial security for family members pending the distribution of the estate and to protect spouses from unintentional disinheritance, can be vitally important. When such waivers are being proposed, each of the individual rights should be considered, understood, and weighed as part of negotiations. Again, if the family law drafter or reviewing attorney is not sufficiently familiar with the meaning and import of each of these rights, estate-planning counsel should be brought on board to assist.

One Size Does Not Fit All: Important Process Considerations

Traditionally, the premarital agreement is drafted by the attorney for one spouse, most often the wealthier of the two. Rarely does the couple discuss or negotiate the terms of the agreement in depth with one another directly. Often an awkward discussion or two will have occurred in which one spouse is essentially notified that "a prenuptial agreement" is being requested/demanded as a condition for marriage.

Similarly, rarely does the spouse requesting the premarital agreement spend significant time with his or her attorney getting educated about the options for the premarital agreement terms along the lines of the operating agreement analogy outlined above. Instead, it is simply presumed by the drafting attorney that the purpose of the agreement is to "protect" the assets of the wealthier spouse from the weaker spouse in the event of divorce. After the agreement is fully drafted, it is presented ready for signature to the other party and his or her attorney. A series of negotiations then sometimes takes place, often through the lawyers directly. At the end of the process, the agreement is signed, with the intention that the dreaded document be placed in a drawer or "box of hate," never to be needed or thought of again. As one blogger commented, "It doesn't take a rocket scientist to see the harm such a prenuptial agreement can do to a marriage. During the negotiations, feelings are harmed, generally irreparably… The feeling of being abused and marginalized persists throughout the marriage."[16]

In recent years, however, there has been a growing trend towards a more collaborative model for negotiating and drafting premarital agreements. In thinking about the better premarital agreement, it is important to choose professionals *willing* to educate both parties about these alternative options before any agreement is drafted and who are *able* to competently guide the parties through whatever process is appropriate for the particular case.

The two most common alternative approaches to the traditional model are the collaborative, or 4-way model, and the mediation, or 5-way model. In both of these approaches, frequently the expertise of other professionals, non-family law attorneys, is sought out. These can include estate planning advisors, tax advisors, mental health counselors (for communication, wealth and goal setting issues), and financial planners. Comparing the traditional process model and these more collaborative models, the two greatest differences are 1) moving the parties from the background to the foreground of negotiations over the agreement's terms, and 2) creating a customized agreement at the end of the discussions instead of starting from a presumptively correct complete draft that "protects" one party's interests over the other.

In the 4-way model, as described by Donna Beck Weaver in her excellent article on the topic, "[w]hen the collaborative process is used, the written agreement is prepared last, and only after the partners have discussed the issues and concerns important to them and their shared life, and have reached shared agreements about those concerns."[17] In the 4-way process, the parties meet with both the group and separately

with their own attorneys to complete the disclosures, and outline and negotiate the terms of the agreement. All of this happens before pen is put to paper so that, when both attorneys draft the agreement, the parties' mutual goals and interests are fully understood and implemented. As Weaver explains, "In the course of their four-way discussions, the couple can plan for the major foreseeable life transactions that are likely to occur during their marriage, such as acquisition of a family home, the bearing of children, the trajectory of careers, planning for the family's protection in the event of the disability or death of one of the partners. The process thus becomes a valuable exercise in thoughtful planning for the health and well-being of the marriage and the new family itself. It becomes far more than a paper moat around one party's separate property."[18]

In the 5-way model, a mediator is engaged to meet with the parties directly, most often without the attorneys present. The mediator acts as a neutral facilitator and information provider and assists with gathering the disclosure information and creating the first draft of the agreement. Parties still enlist the services of separate attorneys to help hone and refine their individual interests as well as to evaluate proposed agreement provisions, but this is generally done outside the mediation room. Again, the agreement is drafted at the end of the process. As with the 4-way model, the parties are educated together about the legal context, disclosures, and options for the agreement's terms. Any negotiations about substantive terms occur between the parties directly, since no attorneys are present to speak for them, and their conversation is facilitated by the neutral mediator. As summarized in a recent blog by Laurie Israel, "[m]ediation is an excellent way for people to resolve their differences and have clear communications. A mediator can help level the playing field, and elicit all thoughts and concerns of both parties in a non-confrontational setting. Mediating these conversations helps the clients discuss difficult issues without emotions, anger and hot speech overcoming them."[19]

Whether a particular premarital agreement should be negotiated and drafted using the traditional model, the 4-way collaborative model, the 5-way mediation model, or some hybrid approach depends on a number of factors, including: relative sophistication/bargaining power of the parties, cost concerns, and personalities/comfort level of the various professionals involved. The important thing for the practitioner seeking to assist couples with a better premarital agreement is to be aware that one size simply does not fit all. ■

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1 According to a 2013 online survey conducted by the American Academy of Matrimonial Lawyers of its nationwide membership, "63% of divorce attorneys cited an increase in prenuptial agreementtial agreements during the past three years…" *Increase of Prenuptial agreementtial Agreements Reflects Improving Economy and Real Estate Market: Survey of Nation's Top Matrimonial Attorneys Also Cites Rise in Women Requesting Prenuptial agreements*, October 16, 2013, http://www.aaml.org/about-the-academy/press/press-releases/pre-post-nuptial-agreements/increase-prenuptial agreementtial-re.

2 Ruskus, Geniveve,. *2015 Survey of Northern California Chapter of the American Academy of Matrimonial Lawyers.*

3 *Id.*

4 *Id.*

5 A recent study conducted by Heather Mahar, a fellow at the John M. Olin Center for Law, Economics and Business at Harvard Law School estimated that only between five to ten percent of marrying Americans get prenuptial agreementtial agreements. *For Many, Prenuptial agreements Seem to Predict Doom*, HARVARD UNIVERSITY GAZETTE, January 31, 2015, http://news.harvard.edu/gazette/2003/10.16/01-prenuptial agreement.html.

6 *Operating Agreements; The Basics," Small Business Administration*, January 27, 2015, https://www.sba.gov/blogs/operating-agreements-basics-0.

7 *Id.*

8 The community property states are Alaska, Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin.

9 *Comparing Equitable Distribution and Community Property for a Divorce*, LEGALZOOM DIVORCE EDUCATION CENTER, January 31, 2015, http://www.legalzoon.com/divorce-guide/equitable-distribution-community-property.html (emphasis added).

10 IRC § 1014(b)(6).

11 DAWN GRAY AND STEPHEN J. WAGNER, COMPLEX ISSUES IN CALIFORNIA FAMILY LAW- VOLUME B: FIDUCIARY DUTIES – A PRACTICAL APPROACH: HANDLING FIDUCIARY DUTY ISSUES IN THE DAY-TO-DAY PRACTICE OF FAMILY LAW B46-B414 (Matthew Bender 2005).

12 *Id.* at B4-12.

13 *See, e.g., Somps v. Somps.* 250 Cal. App. 2d 328 (1967). In upholding a trial court's ruling that husband's decision to purchase a property using his separate property, even though community assets were available, was *not* a breach of his fiduciary duty, the Court famously explained, "[t]he fact that husband purchased the … property with his separate funds, as the trial court found, is not evidence of taking any undue advantage nor is it a breach of a fiduciary relationship which would invoke a presumption of fraud or undue influence. There is no reason why husband should be compelled to keep his separate funds idle." *Id.* at 338.

14 23 Cal. 3d 590, 600 (1979).

15 CAL. PROB. CODE § 21700; CAL. FAM. CODE § 1612(a)(3).

16 *Is Mediating Prenuptial agreements a Form of Marital Mediation?*, THE HUFFINGTON POST, February 7, 2015, http://www.huffingtonpost.com/laurie-israel/is-mediating-prenuptial agreements-a-form-of-marital-mediation.html.

17 Donna Beck Weaver, *The Collaborative Law Process for Prenuptial agreementtial Agreements*, 4 PEPPERDINE DISP. RESOL. L. J., (Issue 3) 337, 340 (2004).

18 *Id.* at 341.

19 *Is Mediating Prenuptial agreements a Form of Marital Mediation?*, *supra* note xvii.