

Prenuptial and Postnuptial Agreements in Business and Estate Planning

By Jeffrey M. Fetter and Alan S. Burstein

Business and estate planners are generally very careful about having documentation and agreements in place that address what is to happen with a person's business interests in the event of death, disability, termination of employment, etc. Buy-sell and shareholder agreements spell out in detail the various procedures that will be followed in order to ensure that business interests stay with the parties that are active in the operation of the business. Wills and trusts will carefully dictate how family business assets and other assets will be distributed among business and nonbusiness heirs in the event of death. However, what is often overlooked in business and estate planning is how such assets are to be protected in the event a business owner is involved in a matrimonial action. As a result, not only is the business owner's interests in the business at risk, but the entire business operation may be disrupted as a result of having to be involved in the matter.

"Divorce is too prevalent to ignore. The planner must assume that during the life of a business, one or more of the owners is going to go through a divorce."

Business and estate planners must understand and appreciate the value of having marital agreements in place for their clients. If a client dies intestate, it is the law that directs how a person's assets are distributed at death. Similarly, without a written prenuptial or postnuptial agreement in place, it is the law of equitable distribution and the courts that direct how business and other assets are to be divided between spouses in the event of divorce.

Divorce is too prevalent to ignore. The planner must assume that during the life of a business, one or more of the owners is going to go through a divorce. It may even be the case where the husband and the wife are the only owners of the business. In any case, advance planning is important to protect the business. Without a plan in place, the business may not survive and as a result, everyone suffers. Many times it is the business that suffers the most.

This article will address the basic structure of marital agreements and how they can be used in connection with business succession planning.

Prenuptial or Antenuptial Agreement

"A contract made between persons in contemplation of marriage, remains in full force after the marriage takes place" (General Obligations Law § 3-303).

Postnuptial Agreement

This is an agreement entered into between husband and wife during the marriage.

Separation Agreements

Economic and family issues may be resolved by a separation agreement. Under section 170(6) of the Domestic Relations Law, a separation agreement can be used to facilitate a divorce. That is, living separate and apart pursuant to a separation agreement for at least one year provides grounds for divorce.

DRL § 236(B)(3) provides that an agreement made before or during the marriage shall be valid and enforceable in a matrimonial action if such agreement is in writing, subscribed to by the parties, and acknowledged or proven in the manner required to entitle a deed to be recorded. Prenuptial and postnuptial agreements, when properly prepared and executed, allow spouses to "opt out" of the statutes and rules and address between themselves:

- Testamentary issues between the parties or a waiver of any right to elect against the provisions of a will;
- Provision for the ownership, division or distribution of separate and marital property;
- Maintenance and support arrangements between the parties (so long as such arrangements are not deemed to be unfair or unconscionable and, with respect to children, meet the requirements of DRL § 240).

Family business assets may be the greatest but the most illiquid asset of a family. If a business owner is required to liquidate business assets in order to satis-

fy an obligation to a former spouse of an owner, the business may have to be sold in its entirety. If the business must borrow funds from third parties, the adverse effect on cash flow may cripple the business's operations and its ability to borrow for business operations purposes.

One spouse may be a party to shareholder or other owner agreements within the business and it is necessary to plan for the orderly transfer of one owner's interest to the other:

- Owners wish to keep business and business assets out of an owner's marital problems (and vice versa). Marital problems cause a great deal of emotional distress within the business.
- Owners do not want their partner's former spouse as co-owner or creditor of the business.
- The long-term family business succession plan may be disrupted by divorce.
- Family business may be multi-generational. The family may intend on keeping business assets within the family.

A prenuptial or postnuptial agreement can determine how spouses' assets will be divided in the event of divorce. Without such an agreement, the definitions of "Separate Property" and "Marital Property" under the law will control.

Separate Property as Defined Under DRL § 236(B)

- Property acquired before marriage.
- Property acquired by bequest, devise or descent or by gift from a party other than the spouse.
- Compensation for personal injury (pain and suffering).
- Property described as separate property by written agreement of the parties, i.e., a prenuptial agreement.
- Property acquired in exchange for or the increase in value of separate property, except to the extent the appreciation is due in part to contributions or efforts of the other spouse.

Marital Property as Defined Under DRL § 236(B)

This is all property acquired by either or both spouses during the marriage and before the execution of a separation agreement or the commencement of a matrimonial action, regardless of the form in which title is held.

Requirements for Valid Prenuptial Agreement

Financial Disclosure. Both parties must acknowledge that there has been full and sufficient disclosure of each party's assets and liabilities. Insufficient disclosure can create the presumption of overreaching and misrepresentation, which may invalidate the agreement.

Representation by Counsel. It is important that both parties be independently represented by counsel. The fact that one party was not represented does not, per se, invalidate the agreement. However, it is a consideration if taken into account with other factors. New York State Bar Association Ethics Opinions have determined that it is improper for an attorney to represent both a husband and a wife even if it is a friendly separation or uncontested divorce (NYSBA Ethics Opinion No. 258).

Acknowledgment of Signatures. Both parties' signatures must be notarized, using the same language as is used to record a deed.

Timing. A prenuptial agreement may appear to be induced by undue influence and signed under duress if entered into close to the day of the wedding, causing the agreement to be invalid.

Fairness. The agreement must be free from undue and unfair advantage and overreaching on behalf of one party over the other.

Legal Authority. New York Domestic Relations Law § 236 B(3) provides the legal authority for prenuptial agreements. DRL § 236 B(3) requires that the agreement is subject to the terms of New York General Obligations Law § 5-311.

Writing. Agreements must be in writing, since oral agreements are not enforceable.

Signatures. Agreements must be signed by the parties.

Acknowledgment. Agreements must be acknowledged or notarized *in the same manner as required to record a deed*. Simply having an agreement notarized is not sufficient.

Designing a Marital Agreement for a Closely Held or Family-Owned Business Owner

Spouses' Intentions and Issues to Be Addressed in the Agreement

Do the parties intend to segregate "business assets" from the marriage? If so: In all cases? Death and divorce?

Parties may only wish to have the agreement apply in the event of divorce or separation, not in the event of death.

Will the agreement expire after a period of time?

If the agreement applies in the event of death, have other arrangements been made for the surviving spouse? E.g., if there are children and the former spouse has no independent means of support, life insurance or other forms of financial support may be required in the agreement. In a second-marriage situation, it may be appropriate to have a life insurance policy on the life of the business owner with the spouse or a trust the beneficiary. This then assures the spouse of being protected while the business owner ensures that the business itself is protected.

Is maintenance for the nonbusiness spouse to be waived? If not, on what basis will maintenance be determined?

If business assets are excluded from equitable distribution, how are "business assets" defined?

Original business interests only? What if the family business expands and a new "business" is acquired by the business spouse (i.e., ownership in the "new" family business)? Will the new entity be excluded?

What if all or part of a "business asset" is sold? Are the proceeds "business assets"? If income is earned on the investment account holding those assets, is the income "separate property" or "marital property"?

How is "income" from family business assets (other than compensation) categorized? E.g., if dividends are received and placed in separate account, does it remain "separate property"?

What if business assets are utilized to buy a home for the couple? What if business assets are used by one spouse for a down payment on a home? Does that down payment retain its separate property character?

What if the husband and wife are the only owners of the business? The agreement should address who stays and who leaves in order to "divorce-proof" the business. Otherwise, marital disharmony can have a disastrous impact on the business operations. If there are multiple businesses, the agreement should address who receives each business asset. There is a need to address when the responsibilities are to be divided in order to protect the business (i.e., it should not wait until formal divorce decree?).

Other Business Owners' Intentions

Does buy-sell agreement among business owners cover "divorce"?

Owners may not wish the act of being in a divorce proceeding as an event that triggers a buyout, but may it be desirable to have as a triggering event any act that

results in a spouse acquiring ownership in the entity? E.g., a divorce decree or written separation agreement. Such an event would then allow the remaining owners or the entity to purchase the interest of the nonbusiness spouse. Should this be mandatory on the part of the entity and other owners or an option?

Should an agreement give "call" rights to an entity and/or other owners in the event an owner is involved in a matrimonial action, to avoid being subjected to depositions, appraisals, investigations by a spouse's advisors, etc.? If so, a court may determine that having such a provision only applicable in such an event may be unconscionable and unenforceable.

If an entity incurs expenses as a result of an owner being involved in a matrimonial proceeding, who incurs those expenses? E.g., appraisal fees, loss of income from having to participate in depositions, hearings, trials, etc.

The agreement may provide that in the event of a transfer to a spouse pursuant to a divorce decree that the interest acquired is a nonvoting interest.

The agreement *may not* provide that the business owners' interest is valued differently in the event of a divorce proceeding. Such provisions have been determined to be unenforceable.

What if each of the spouses is an owner of the business? A spouse may be an owner for estate planning purposes, tax purposes, creditor protection purposes or because the spouse is active in the operation of the business. Should the agreement specify how the ownership of the "less active" spouse will be acquired and when?

As the business expands to multiple generations, care must be taken in ensuring agreements address how divorce will affect future ownership, management, etc.

Summary

Business succession planning must take into consideration the likelihood that an owner and a spouse may be divorced at some point in the future. In order to protect "family business assets," appropriate agreements should be entered into prior to the marriage.

The business must be protected from disruption whether it is a two-person, husband-and-wife operation or a multiple-owner entity with related and unrelated individuals as owners.

Agreements should be carefully designed depending on the facts and circumstances surrounding the marriage and the business operations.

Review the agreement periodically to determine if the agreement is consistent with the structure of the business and the estate plans of the owners of the business. A review may be appropriate at the same time that a client would review his or her estate planning. That is, if there have been changes in business ownership, financial situations, family situations, or in the tax and other laws that affect a business's operations, the agreement should be reviewed.

If you are representing a multiple-generation family business, remember to express to parents that in the past, one of them was the "in-law." Therefore, it may be appropriate to terminate or modify agreements at some point in the future.

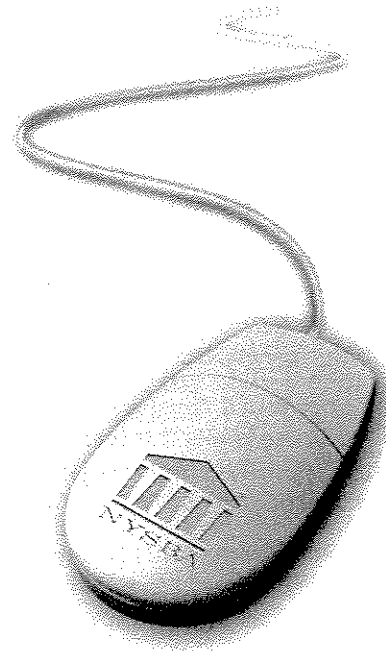
Keep tax considerations in mind when discussing and entering into a prenuptial or postnuptial agreement. It is difficult to determine the most tax-advantageous provisions to include in a prenuptial agreement when the effective date of a split-up is (1) not contemplated and (2) many years in the future. Therefore, the need to periodically review the agreement remains necessary (keeping in mind that at least one of the parties probably would prefer not to have an agreement at all and this can be re-raising a very sensitive issue within the family (and within the business)).

Be consistent with all the business owners. If a prenuptial agreement is necessary for one owner, it should be necessary for all owners. The buy-sell agreement must be kept up-to-date to reflect the then-current intentions of the parties.

The subject of a prenuptial agreement is always difficult to broach. The initial reaction is many times one of feeling distrusted. The bride- or groom-to-be believes his or her fiancé's family or partners do not have trust in them. However, as difficult a subject as it is to bring up, it is important to do so as part of the overall succession plan for a family or closely held business. It may have to be the attorney or other advisor involved in the planning that proposes prenuptial agreements as part of the long-term plan for the business. It may need to be the same advisor who discusses this with the parties involved.

Jeffrey M. Fetter and Alan S. Burstein are partners at the law firm of Scolaro, Shulman, Cohen, Fetter & Burstein, P.C in Syracuse, New York.

Your CLE Classroom



- Get the best NY-specific content from the state's **#1 CLE provider**.
- Take "Cyber Portable" courses from your laptop, at home or at work, via the Internet or on CD.
- Stay at the head of your profession with outstanding CLE instruction and materials.
- Everything you need to obtain full MCLE credit is included **online** or **on CD!**

Come click for CLE credit at:

www.nysbaCLEonline.com

or to purchase CDs
call 800-582-2452