

# ACFLS

# NEWSLETTER

NEWSLETTER EDITOR

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## ADVICE TO A CLIENT BEFORE SIGNING A PREMARITAL AGREEMENT

BY

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*"For to be wise, and in love,  
was not given to the gods themselves."*

*Aphra Behn,  
The Confession of the  
New Married Couple*

A premarital agreement may be challenged either at the time the parties to the agreement divorce or when one of them dies. There is a risk that the premarital agreement will not be enforced. At that time, circumstances may be quite different from what they are now. The law may change, or a party who was once wealthy may no longer be wealthy. Mental and physical health declines. Memories fade. Parties may not keep their promises under the agreement. They may commingle their assets. They might not amend the agreement when it is necessary. They may divorce in another state or country where the agreement will be meaningless. They may even lose the agreement.

Although it is impossible to protect your clients from every eventuality, it would be wise to memorialize your advice as to the possible circumstances that might make the agreement unenforceable. Some of the risk of a set-aside can be ameliorated by a client who takes certain precautions. Encourage your client to consult with you in the future if there is a change in its circumstances.

Mr. Wainright owns homes in several countries and states. He is wealthy. He is getting married to Ms. Cherie. They already have a child. You have been asked to represent him in the event the couple ends up getting divorced in California. What follows is a letter you may want to write him.

### **Re: Wainright and Cherie Premarital Agreement**

Dear Mr. Wainright:

The purpose of this letter is to summarize some of the issues we have discussed in connection with the premarital agreement you have asked me to prepare. Some of these points have been made before; they are repeated here so that you have in one document all of the advice I have given you.

### **The Risks of Marriage and Divorce**

Even with a premarital agreement, marriage is a risky partnership. Under California law, the working spouse can be ordered to pay 60 percent of his income in child and spousal support. In a divorce, businesses are valued for more than they can be sold for; in fact, even if your business cannot be sold, it can have a value in a divorce. Attorney and accounting fees can be extraordinary with or without a premarital agreement. On occasion courts set aside premarital agreements and do not enforce them. The only sure way to shield yourself from a costly divorce is not to get married.

### **Selecting a Suitable Place to Marry and Be Domiciled**

You have chosen to marry and reside (at least part of the time) in California. A person with significant wealth such as you may choose a domicile such as Texas, where there is only limited alimony, or Florida, where child support is based on the reasonable needs of the children and not necessarily on the standard of living of the payor. You have analyzed these alternatives and rejected them. I do not make a recommendation as to where you should be married and later domiciled.

### **Why You May Need a California Premarital Agreement Even if You Do Not Plan to Live Here**

Even if you personally do not live here, California can assert jurisdiction over you for the purposes of ordering support and attorneys' fees, and possibly make orders for the division of certain property, if you are personally served with a Petition for Dissolution of Marriage, legal separation or annulment in California, owned property in California, had certain minimum contacts with the State of California (including possibly doing business here), or caused an effect in California. Making a threat over the telephone to your wife could be considered causing an effect in California. Sending an email could conceivably be considered sufficient contacts with this state to establish jurisdiction.

A court can grant a divorce as to status-only to your wife even without jurisdiction over you (but it would not make monetary orders). We are a "no fault" state, so there does not have to be proof of some wrong such as adultery. But, if a party commits domestic violence against the other; that fact can be considered by a court in ordering higher support or awarding sole custody to the non injured party with very limited visitation to the perpetrator. There could be serious criminal consequences as a result of committing domestic violence.

We also follow a rule of law called the doctrine of divisible divorce. That means that each aspect of a divorce is treated differently for jurisdictional purposes. For example, if your wife has been here six months with your child with your consent, California could maintain jurisdiction over custody and visitation, but unless you had minimum contacts with the state a court could not make any financial orders against you, including child support. If your wife were to come here with a child without your permission, you would have to act promptly to seek return of the child. If she remained here six months, California could acquire jurisdiction over custody. If she came here while pregnant and did not return, California could acquire custody jurisdiction, even if she were here less than six months.

By preparing this California agreement, I have not recommended California as a "good" place to obtain a divorce. In fact, it may be one of the worst states to get divorced. Our spousal and child support are high compared to some other states. The child support is based on the standard of living of the father. Our spousal support is based on the marital standard of living, whether the parties save their money or lavishly spend it on G5 jets and mansions.

Here is what a California premarital agreement does and does not do. It is designed to apply if you are divorced in California only. It may apply if you are divorced in any of the other 49 states, but that is not assured. If you want to ensure that it would be enforced in other states such as New York or Florida, I recommend that you authorize us to retain counsel in those states on your behalf. The agreement will probably not be enforced in foreign countries. Many countries have matrimonial regimes based on an entirely different system of marital law. In those countries, persons who are getting married can select one of various marital regimes. This is done before a notaire, a quasi-judicial official who allows the parties to elect a separate property regime or a regime of shared property. France, Portugal, and Austria are examples of countries that have marital regimes.

### **Premarital Agreements Cannot Regulate Child Custody, Religion, or Personal Issues**

Premarital agreements cannot regulate child custody. Custody decisions are based on what is in the best interest of the children at any given time (with certain exceptions). Premarital agreements cannot limit child support, as it is regulated by public policy considerations. Premarital agreements cannot regulate a party's right to worship in a certain religion or regulate how a child will be raised in a certain religion. Premarital agreements cannot cover a person's habits, such as who

will wash the dishes, whether a person will drive quickly or slowly, or whether someone will pick up his or her clothing. Nor can they punish someone for being unfaithful. Premarital agreements are contracts that can modify only certain California laws.

### **Primary Value of Premarital Agreements: Waiving Community Property Law**

The primary use of premarital agreements is to waive California's community property law. Community property must be divided equally by a court. Community property is any property acquired during the marriage while the parties are living in California that is not a gift or an inheritance (which is separate property and awarded to the party who received it). Property owned before marriage is separate property and cannot be divided by a court. Efforts to enhance separate property businesses or other separate property, create a community property interest in that separate property. The determination of what is separate and what is community property often requires the use of forensic accountants. In high-asset cases, the accounting and legal fees can run into the hundreds of thousands, or even millions, of dollars.

Furthermore, in determining whether a business owned before marriage has any community interest, the property must be valued both at the time of marriage and at the time of separation, and sometimes again at the time of the divorce trial, which can be years after filing for divorce. Similar calculations are made for real estate and intellectual property. Furthermore, earnings are community property. If you married without a premarital agreement and earned \$50,000,000 during your marriage, that entire sum would be community property. That means your wife would own one-half of that property and anything purchased with that property.

Furthermore, if you lost any of that money in a bad investment or mismanaged your assets, your wife may have an action against you for a breach of fiduciary duty. And if you reinvested those earnings in a separate property business or any other property, your wife could request that you reimburse the community for the money spent. In a long marriage, that tracing may be impossible to do, and sometimes the separator forfeits his interest.

Under California law, the proceeds of loans are community property under certain circumstances. If an individual owns companies and uses financing or factoring to finance a business, the loan proceeds can be so commingled in the business, that the owner can end up losing his separate property interest. If you refinance your real estate, you may be contributing community property to

your separate property asset.

Community property law fills many volumes of legal books, and the field is becoming more complex. It is impossible to outline every circumstance that is covered by the law. Suffice it to say that with a proper premarital agreement, the parties can waive their community property rights - if they comply with the executory terms of the agreement and if they keep their separate property separate.

### **Estate Planning Aspects of the Agreement**

A premarital agreement will also allow people to waive their probate rights. If a party dies without a will or trust made during the marriage, the spouse has certain property rights and rights to support from the estate of the person who dies. The premarital agreement that I drafted waives these rights of intestacy as well as the right of your wife to administer your estate. It creates a situation where the only way your wife could make a claim on your estate is through a will or trust that you write. This can avoid unnecessary and expensive will contests where a spouse makes claims based on the law when there is a will or trust.

I advise you to prepare proper estate planning documents that will protect your wife and your children. Proper estate planning can avoid ugly postmortem fights about your estate and avoid certain estate taxes. This could be difficult because it is not clear in what state or country you will be residing when you die.

Often the estate planning aspects of the agreement are negotiated with the other party to the agreement. In the current draft of the agreement that is being sent to your wife, she is entitled to nothing at your death. You should consult with estate planning counsel to determine whether your estate plan should be modified in light of this agreement, your marriage, or the birth of your child.

I expect Ms. Cherie's attorney to demand that she be guaranteed in the document some portion of your estate at your death. In that way, the agreement will act as a contract to make a will or trust. I would encourage you to be flexible on this point. Life insurance can also be considered as part of the estate planning process. At your age, it is inexpensive and may make sense in the context of your overall estate plan.

Many clients retain an expert in estate planning to draft this aspect of the agreement. I do not specialize in this area of law. If Ms. Cherie asks to be named in your will or trust, tax consequences will need to be considered. If this is an issue, I will recommend estate planning counsel. Special planning will need to be made if Ms. Cherie is not a United States citizen.

## Spousal Support

Until very recently, under California law, parties to a premarital agreement could not waive or limit spousal support. Many other states permit this waiver. The law currently allows parties to waive or limit spousal support, unless that limitation or waiver is deemed unconscionable at the time of the divorce. Because our statute is new, we do not know how a court will interpret the word "unconscionable." We can only speculate as to whether the court will interpret an unconscionable agreement to be one that leaves a person on "state aid," as do many other states, or whether they will look at the relative circumstances of the parties. At this point, I cannot advise you on whether a court will enforce this provision. In some cases, we set up a trust to provide for the spouse. If the spouse seeks spousal support or contests the support waiver, she forfeits the right to benefits under the trust.

You have insisted that the agreement not provide for any spousal support to Ms. Cherie. Due to your significant wealth, a waiver of spousal support may be determined to be unconscionable by the court who receives the agreement. By waiving spousal support, I believe that you are jeopardizing the validity of this paragraph. I recommend that the agreement provide for a reasonable amount of spousal support to Ms. Cherie. Otherwise, a court may set spousal support on its own, in an amount which you do not find reasonable.

## Consideration or Payments to Ms. Cherie

A well-drafted premarital agreement provides an incentive for the persons signing it to honor it. If the agreement is not sufficiently generous, there is an incentive for your spouse to attack the agreement. A good agreement will be fair. If the agreement does not provide sufficient assets for a party, that party is likely to file an action to set aside the agreement, leading to an expensive divorce. Furthermore, there is the chance that a court might set the agreement aside. We have included in our agreement an interrum clause which states that a party who contests the agreement, will forfeit any benefits under the agreement. Although this clause may not be enforceable, it may provide a disincentive to litigate the validity of the agreement. This clause may not be enforceable in California and other states.

The agreement provides for payments to be made to Ms. Cherie upon each yearly anniversary of marriage for the first 10 years. These sums must be paid when due. Otherwise, your lack of performance under the agreement may prevent you from enforcing

the agreement. We have placed a cap on the amount of these payments that limits their total to one-half of your net worth.

## Tax Issues

We have discussed that the transfers you make to Ms. Cherie during marriage strengthen the agreement. Typically, property transferred between United States residents who are married are tax free. In the United States, non-resident aliens are taxed on transfers, which are treated either as a gift on which the transferor will pay a gift tax or as a payment of income or a sale. You should consult with competent tax counsel in the countries where you are living to determine the best way to treat the transfers between you and Ms. Cherie. You must make sure that you and Ms. Cherie file tax returns that are consistent and that take into account the transfers mandated by the agreement.

Further, you have indicated that you paid Ms. Cherie \$500,000 prior to marriage. This transfer may have tax consequences, either in the United States or elsewhere. I recommend that both of you seek competent tax counsel to advise you with regard to the consequences of the transfers made to Ms. Cherie both before and during marriage.

## Amendments to Agreement

A marriage can be relatively short or last for 40 years. Over that period, laws change, fortunes can be made and lost, and where you live can change many times. Because of these changes, it is hoped that when there is a major change or a passage of time you will have your attorneys' review the agreement and make sure it still applies to your situation.

The California agreement is currently a "back-up" agreement, written in the event one of you files for divorce in California. In the event that you and/or Ms. Cherie move to California, buy property here, or begin to travel regularly here, you should amend the agreement to cover the specific situation at the time.

If your assets decrease, you may also want to change aspects of the agreement so the burden of the property settlement is not so heavy that you cannot meet it. At the moment you have wealth, but circumstances change and it may be, however unlikely, that Ms. Cherie has the wealth and that you do not. Because you have waived spousal support, you would have no right to obtain support from Ms. Cherie. You have waived all your rights to share any of Ms. Cherie's property.

In the past five years, there have been two major revisions in California case law relating to premarital agreements. It is likely the law will continue to change. I recommend

you review the agreement regularly to protect against changes in the laws of the jurisdictions you live in.

## Disclosure

The problem of how much disclosure is sufficient is a difficult one under California law. Ordinarily, unmarried persons do not have a fiduciary duty to each other, so the level of disclosure may be less than full, although California law is conflicting on this point. One sentence of the Family Code §1615 says "a full, fair and reasonable disclosure" is required, and the next sentence permits parties to waive disclosure beyond the disclosure that is provided.

On the other hand, it could be argued that you have a fiduciary duty to Ms. Cherie which would require full disclosure because Ms. Cherie and you have a child and you live together.

We have discussed various possibilities for provide providing Ms. Cherie a full disclosure without being specific about exact values. At the time of this letter, we have prepared a very general disclosure that states that the net worth of your businesses and properties is not less than \$20,000,000. This may not be sufficient disclosure.

I am concerned that a court would find that Ms. Cherie could not properly negotiate the agreement and give a knowing waiver of her rights without having adequate knowledge of your finances.

I am willing to work with you in providing Ms. Cherie a disclosure that protects your privacy, but provides her attorney with sufficient information to negotiate.

You have elected not to provide us with detailed information regarding the nature and extent of your assets. You have also asked that we not provide your tax returns or any detailed disclosure of your assets. Although we are cognizant of your need for privacy, please keep in mind that the limited disclosures made in the agreement may not be deemed sufficient and may imperil the validity of the agreement.

## Confidentiality

Ordinarily, discussions between an attorney and client are confidential under California law, but it could be argued that by my certification of the premarital agreement you are waiving the attorney - client privilege, even though the certification says you are specifically not waiving the privilege. I recommend that you do not show or discuss this letter with anyone because that could be considered a waiver of the attorney - client privilege.

## Signing the Agreement

Perhaps the best way to ensure that the agreement is understood and entered into voluntarily, is to videotape the signing of the agreement. Short of doing that, we must arrive at a way of making sure that Ms. Cherie confirms that she understands the entire agreement and that she has been properly advised of all its terms. Ms. Cherie must notarize the agreement. I suggest that the agreement be executed with six "original" signatures. It is critical that you work with me to make sure I receive a fully signed agreement before you marry. You must also maintain a copy with your records, assuming I may not be practicing law or alive. I recommend that you maintain several copies in safe deposit boxes.

I would like an opportunity to review the agreement with you over the telephone before the final version is mailed to Ms. Cherie and her attorney. I will ask you to acknowledge that you have been provided with the opportunity to ask any questions of me or any other adviser, to seek a second opinion, or even to have another attorney take over the preparation and negotiation of the agreement, if you so choose.

By countersigning this letter below my signature, you confirm that each and all of the following are correct:

1. You understand the provisions of this letter.
2. You agree to the terms that will be presented to Ms. Cherie in the California premarital agreement.
3. You understand what the California premarital agreement does and what it does not do.
4. You understand that you have an absolute right to independent legal counsel to advise you with regard to your rights and the advisability of signing this letter, and that if you have any reservations at all about doing so, I recommend you obtain independent legal counsel.

## Enforceability of the Agreement

Enforceability depends on facts or laws that arise in the future. I do not guarantee that

the agreement is enforceable. It is best to view the agreement as a document that can strengthen your bargaining position in the event of divorce. At that time, you can determine whether it is applicable and enforceable.

Possible reasons the agreement may not be enforced:

1. It may not be enforceable if you do not live in California.
2. The spousal support clause may not be enforceable even if you do live in California because it is deemed unconscionable at the time of the divorce.
3. It may not be enforceable if California law changes.
4. It may not be enforceable if you do not keep your separate property separate.
5. It may not be enforceable if you enter into conflicting agreements in other states or countries.
6. It may not be enforceable if you do not keep a copy of the agreement.
7. It may not be enforceable if Ms. Cherie establishes that she was forced into signing the agreement or that she did not know what she was doing when she signed it. Ms. Cherie could even claim that you were in a "confidential relationship" under California law, that you owed her a fiduciary duty at the time of marriage, and that you breached that duty.
8. It may not be enforceable if Ms. Cherie claims she was not adequately represented by a competent and independent attorney.
9. It may not be enforceable if the California premarital agreement statute was not followed in that you did not provide Ms. Cherie with a full disclosure of your assets and obligations.

10. It may not be enforceable if you do not comply with your obligations under the agreement.

11. It may not be enforceable if it is deemed to be promotive of divorce.

12. It may not be enforceable for reasons that we cannot anticipate.

13. It may not be enforceable if one of you sign it less than seven days after the last draft or version is presented.

In spite of the pitfalls, most premarital agreements are enforced in California with regard to the division of property. Whether a court will enforce the waiver of spousal support is a question that would be up to a judicial officer, who must determine whether the waiver or limitation is unconscionable at the time of divorce.

Thank you for your understanding and cooperation, and this opportunity to represent your interests in negotiating this premarital agreement.

Yours very truly,

Counsel for Mr. Wainright

## Acknowledgment

I have read and understood the foregoing, and I authorize my attorney to release the Agreement dated 17 July 2003 to Ms. Cherie's attorney, I am signing this letter of my own free will, without duress or undue influence.

Dated: \_\_\_\_\_

\_\_\_\_\_  
Bentley Wainright

Caveat: The people in this letter are fictional. The names used here are not the names of clients, nor are the facts the facts in any case I have handled. Any resemblance to actual people is coincidental. The legal issues represent some possible issues that may arise in a premarital agreement. Other issues not covered here may arise in your own premarital agreement, and the advisory letter should be tailored to that situation.

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