

Family constitutions

Issues for consideration

Key points

- Family constitutions are highly adaptable documents primarily aimed at helping families pass control of wealth, key investments or businesses to future generations
- A carefully crafted family constitution can help families successfully manage the transition of control to the next generation and deal with the complexities arising from multiple generations having an ongoing interest
- A family constitution is an important piece of a family's estate planning strategy where multi-generational wealth transfer is the desired outcome

What is a family constitution?

1. A family constitution (also known as a family charter, family code or family arrangement) is an overarching document that sets out the desired outcomes and core rules in relation to the ongoing management of a family's wealth, key investments or business (or a combination of them).
2. It works in conjunction with other key documents such as Wills, company constitutions and trust deeds.
3. As family constitutions are specifically tailored to address the desired outcomes of a particular family, it is rare that any two family constitutions are the same.

Some family constitutions are very basic and deal with one or more discrete issues (such as the establishment of a family board). Others are comprehensive handbooks that set out:

- (a) rules for ongoing ownership and participation
- (b) short and long-term goals for the management of wealth, investments or a business (effectively a 'Will' for businesses)
- (c) dispute resolution mechanisms to be followed in situations of conflict.

Role of family constitution

4. A well drafted family constitution will have the following benefits:
 - (a) **Maintain collaboration:** it reflects the collective ideals and intentions of a family structure, which encourages family members to comply with the agreed-upon policies and rules.
 - (b) **Enduring generational changes:** it enables members to remain focused on priority areas while facilitating any change in control.
 - (c) **Managing conflict:** it can outline dispute resolution mechanisms for overcoming family or business conflict in a cost-efficient and discrete manner.
5. Family constitutions can be binding or non-binding, depending on the needs of the family and the issues to be covered.

Certain guiding principles for the family (such as mission statements and family values) cannot be binding. However, they can still be important as they can 'emotionally' bind family members in their dealings with each other.

When is a family constitution useful or essential?

Involvement of next generation

6. A family constitution can facilitate the smooth transition of control of a business from the current generation to the next and future generations.
7. To achieve this, the family constitution may:
 - (a) set out the roles to be filled by each generation, how the roles are to work together and steps for the transition of control of those roles

- (b) establish an advisory board to engage other family members in the decision-making process, to develop the skills they need to take over from the current controllers.

8. Advisory board arrangements can also help future generations manage the family wealth, investments or business by involving third party advisers to supplement the skills of the next generation.

Estate plans insufficient

9. A Will serves to direct where a person's assets will go upon their death. Wills do not:

- (a) prepare future generations and other family members for their new roles and responsibilities
- (b) provide dispute resolution mechanisms for conflict in relation to those assets.

10. Family constitutions fill this gap by providing a framework through which parties can achieve their goals for their business, wealth or investments before and after death.

Multiple entities involved

11. Family constitutions can assist with the burden of running multiple entities by having a single document to govern the operation of all entities. This avoids the need for tailored governing documentation for each entity and also eliminates the risk of inconsistencies arising between multiple documents.

Varying participation

12. A family constitution can govern the authority of the operators of a business and the role of the ownership group in running the business. This is important where all family members share an interest in the economic outcome of a business but only some are involved in the day-to-day operations.

Drafting considerations

Issues a family constitution should cover

13. There is no hard and fast rule as to what family constitutions must cover. However, some common issues included in a family constitution are:

Overview	<ul style="list-style-type: none"> (a) purpose and history of the family's wealth (b) define the family purpose, values and goals (c) outline who is encompassed by 'family member' (d) code of conduct
Ownership	<ul style="list-style-type: none"> (a) outline how assets are to be divided and other succession plans (b) the rights and obligations of family shareholders (c) policies regarding future capital requirements of the family business/investments and dividends for individual family members (d) whether a family member can 'cash out' and, if so, on what terms (e) whether a family member can be forced to exit (f) valuation mechanisms (g) individual insurance requirements (h) policies as to ownership and management by non-family members
Participation	<ul style="list-style-type: none"> (a) outline the structure of the family (b) define the role and authority of family members actively running the business or managing the investments (c) establish business boards, philanthropic boards, advisory boards and family councils

	<ul style="list-style-type: none"> (d) rules for nominating, assessing and appointing members to the boards or family council (including the involvement of external parties) (e) define the rules of engagement for the board structure and the relationship with the family (f) timeframes for regular key family meetings
Operational	<ul style="list-style-type: none"> (a) policies regarding employment, including initial education requirements and professional development (b) authority levels of boards and family members in active roles (c) requirements for personal guarantees (d) set reporting requirements and channels of communication (e) remuneration policy for family members (f) key person insurance requirements for active family members (g) rules for appointing and training successors (h) procedure for assessing performance of family member employees
Other	<ul style="list-style-type: none"> (a) update and review processes for the family constitution (b) conflict resolution strategies and procedures (c) media and confidentiality policies

Key factors to consider

14. The more comprehensive a family constitution is to be, the more critical it is to have the whole family participate in the process. Often the process is more important than the actual document.
15. The best results are achieved where a family collectively agrees on core aspects of the constitution before drafting including:
 - (a) whether the family constitution will be binding or non-binding
 - (b) whether the rules will come into full effect from the start or whether the rules will activate at various milestone dates (for example, the death or incapacity of current controllers)
 - (c) how the constitution will work in the context of a person's overall estate plan
 - (d) whether the family or the business/investments will be prioritised
 - (e) whether continued joint ownership will cause family conflict and whether joint ownership will remain in the best interests of the business (e.g. future capital requirements)
 - (f) whether the family constitution will be limited to the next generation or encompass the involvement of multiple generations
 - (g) whether the family constitution will continue to apply after the main asset is sold.

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