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Annual Family Law Institute

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Divorce and the Family Business

Animal hospital/Vet practice owned by both spouses

Service company, spouses own 50/50, divided roles

Husband and husband law practice

Restaurant, husband chef/creative; wife business/money

Franchise business, wife qualified owner, husband manages

Manufacturing company owned by wife's family, husband CEO, adult children work for company

Topics and Discussion Points

Management While Divorce Is Pending

Valuation Issues and Considerations

Liquidity Problem/Payment Over Time

Lookback Provisions

Continuing as Co-Owners/Equitable Trust Options

Sell the Business

Transitioning Ownership to Next Generation/Estate and Trust Planning

Attorney Ethics Considerations Throughout

How Do We Manage While Divorcing

. Maintain the *status quo*?

- Both working in the business
- Marital issues; business issues
- Only one spouse working in business
- Payroll
- Accountability
- Transparency

How Do We Manage While Divorcing

- Access to all financial information
- How key decisions will be made
- Employee relations
- Corporate fiduciary relationship
- Spouse goes to competitor

How Do We Manage While Divorcing

- Preliminary Agreement v. Court Decision
 - What options available?
- *Rambo v. Rambo*
 - Trial court cannot order sale of marital residence in preliminary orders
- Involvement of business counsel, accountant
- Who do you represent? Define roles
- Strategy

Valuation Considerations

- Which side are you on? Buyer or Seller?
- Or, keep options open as a buyer or a seller?
- Joint engagement of valuation expert
- Ethical issues
 - Joint engagement
 - Steering expert
 - Divorce planning

Liquidity Problem/Pay Over Time

- “Selling Spouse” becomes the lender
- Interest rate
- Monthly, quarterly, annual payments
- Liquidity events, recapitalization triggering lump sum payments

Liquidity Problem/Pay Over Time

- Security
- Life insurance, estate planning requirements
- Lien on company stock
- Lien on other property
- Mortgage on real estate (company, personal)
- Record judgment

Liquidity Problem/Pay Over Time

- Subordination/substitution of collateral
- Acceleration clause
- Lender-type covenants
- Limits on distributions, compensation, new debt, *etc.*

Liquidity Problem/Pay Over Time

- Ethical consideration
 - Pay over time may delay payment of atty fees

Selling Spouse—Lookback Provisions

- Pass through income tax entity issues
- Fiduciary claims
- Mutual releases and indemnifications
- Warranty of no imminent sale
- Focus on disclosure and warranty clauses

Selling Spouse—Lookback Provisions

- Lookback provisions if business sold after divorce
 - Time period
 - How to calculate supplemental payment
 - Diminishing percentage?
 - Partial sale, asset sale

Selling Spouse—Lookback Provisions

- Lookback provisions if business sold after divorce
- Extremely complicated to draft
- Involve own business attorney
- Owner spouse unlikely to agree
- Court can't order if trial

Co-Ownership

- Exception, not the rule
- Typically, there is a mutually desired termination point
- Eliminates the need for valuation
- Allows equalization of tax impact
- Provides income to both parties

Co-Ownership

- Legal form, governance
- Create new LLC or partnership
- Each spouse has own business attorney
- Becomes a joint venture/joint enterprise
- Buy/Sell agreement

Co-Ownership

- Who manages? Equal managers?
- If one manages, what key decisions require agreement?
- How to resolve decision impasse
- Compensation if only one is running business
- Required distributions to pay income taxes

Co-Ownership

- Vehicle to manage timely sale of assets, not just for running a business
- If one owner wants out, how to determine value and buy out terms
- Put/Call options
 - Optional buyout per formula/optional sale per formula KEY--Optional

Co-Ownership

- “Owner Auction”
- One owner offers the other to purchase at a certain price and set terms
- Other owner has option of selling per those terms OR buying out the offering owner on those same terms

Equitable Trust Option for Co-Ownership

- When legal co-ownership is not available
- Typically, where marital property is a limited interest in a larger investment that does not allow transfers or division of ownership interests
- Create constructive trust in settlement agreement

Selling Business

- If both parties agree, sale to third party possible
- Engage broker or other selling agent
- If done during dissolution, how to manage process
- Enter into formal agreement “to sell” that court approves?

Selling Business

- If sale will not occur during dissolution process, must come up with how to manage business until sale
- Similar to co-ownership provisions
- How to resolve disagreements on sale price/terms
- Court retains jurisdiction to effect sale

Selling Business

- If one spouse wants the business and the other wants to sell
- Finding third party purchaser
- Likely buyer could be competitor
- Risky, risky, risky

Transitioning Business to Next Generation

- Divorce presents unique opportunity to transition business to next generation
- Cooperating spouses can take advantage of estate tax law to transition ownership tax free
- Engage experienced estate and trust counsel to partner with divorce counsel

Summary

- When a business is involved, don't be limited in your thinking
- Big picture, what is best for your client?
- Seek partnership with specialized counsel if appropriate
- Divorce lawyer? Or, "relationship transition" attorney

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