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Divorce-Proofing Your Business.

4 Effective Steps to Help Ensure Your Business Survives in the Event of Divorce.

By Alia Adkins-Derrick

If you (or a business partner) are married, are making plans to marry, or would like to be married one day, you need to divorce-proof your business.

The occurrence of any number of events could threaten the success, profitability, creditworthiness, and survival of a business. Few business owners, however, consider the devastating impact of divorce from a spouse, a business partner, an investor, a key employee, or even an adult child's soon-to-be ex-spouse can have on businesses large or small, profitable or not. And although most don't have the substantial amount of cash it typically takes to pay off an ex in a divorce settlement (e.g., at least half of your company's value), many fail to take the affirmative steps needed to protect their company in the event of divorce. If you (or a business partner) are married, are making plans to marry, or would like to be married one day, but do not have a plan in place to ensure your business survives in the event of divorce, you had better get one.

The Odds Against Your Company. Given the divorce rates, the odds are that many businesses are likely to be impacted by divorce. According to some studies, the spousal divorce rates for first time marriages are 50-52% while the divorce rates for second and third marriages are 70-73% respectively. Consequently then, ignoring the possibility that your (or your business partner's) fairytale marriage will end in divorce can wreak havoc on more than just emotions. For the unprepared, it can result in the soon-to-be ex being named your business partner, you being ordered/pushed out of your business completely, or can tank your business' creditworthiness and stability. Even worse, it can result in you being forced to sell part or all of the business to pay off the divorce settlement. The reason is simple: business owners

who fail to divorce-proof their companies are subject to prevailing state laws.

What's at Stake in Texas. Every business owner in Texas needs to divorce-proof their business because Texas is a community property state. This basically means that regardless of which spouse owns the property or how it is titled, certain qualifying income, assets, and property that are acquired, developed, worked on, or expanded during the marriage are deemed marital property that is typically owned equally by both spouses (e.g., 50-50 split). Not surprisingly then, businesses started, worked on, invested in, or expanded during the marriage are often one of the biggest marital property assets up for division in a divorce. Absent the right plan, your business—or at least the cash that can be generated from its sale—will be an attractive target for your soon-to-be ex.

Effective Steps to Divorce-Proofing Your Business.

The good news is no matter what you (or your partner's) Facebook status (single, married, or it's complicated), if your company's survival is truly a priority, below are several steps you should take now to divorce-proof your business or at least minimize the potential damage of divorce.

1. Revamp [or Prepare] Company Agreements.

One effective way to divorce-proof your company is to include "in the event of divorce" and/or "community property" provisions in all company agreements that deal with the business' ownership—e.g., an LLC Operating Agreement, a partnership agreement, or a shareholder's agreement. The specific terms of these provisions will vary based on a number of factors including the services or goods your company offers, your company's preferences, and state law. Accordingly, the list of possible terms that follows is not exhaustive and may not apply to every company. Business owners should consult legal counsel to identify any special legal

requirements or needs and what terms work best for their company.

At a minimum, the provision(s) should address the interest, if any, non-owner spouses have in the company and what happens to stock or ownership interests in the event of divorce. Ownership interests might include the right to vote, the ability to run the company or sell stock or interest in the company. If, for example, the provision makes it clear that, upon divorce, the divorcing owner's stock automatically becomes nonvoting, then even if the ex is awarded part or all of that owner's stock he or she will have no say in how the business is run. Your company may want to, or may be legally obligated to, take it a step further to prevent a former spouse from having any ownership in the company. For example, in certain licensed professions state law prohibits company ownership by unlicensed individuals. In this instance, business owners should consider including a buy-sell provision that requires that the company be given the right to buy back all stock, shares, or interest owned by (or awarded by a judge to) the non-owner ex. If this option is chosen, it is important that the agreement also address whether the ex must sell it back for the fair market value or some other predetermined specified price. If the former, the agreement needs to describe how fair market value will be determined. Finally, the agreement should always clearly state when and how payment will be made. For example, the amount will be paid out over a certain period of time (e.g., 24-48 months), the first payment must be made by a certain date, how frequently payments will be made thereafter, and for how much. If written properly, the buy-sell provision's prolonged payment schedule should help prevent business owners from being forced to sell the business to gain the lump sum of cash needed to pay the divorce settlement.

The company agreement should, if feasible, also require that all owners obtain their non-owner spouses' written agreement to be bound by the divorce-proof provisions of the company agreement. The inclusion of such a provision gives business owners a bona-fide reason and excuse to ask their spouse for a business-focused Pre- or Postnuptial agreement.

2. Prenuptial Agreement.

Before you say "I-Do," discuss, negotiate, and sign a written prenuptial agreement ("Prenup") with your future spouse that addresses your business, including, but not limited to, which spouse owns it, his or her percentage of ownership, and the non-owner spouse's right to a divorce settlement pay out. A good time to introduce this potentially awkward subject is early on when the two of you are discussing how personal bank accounts will be held (jointly or separately) and how finances will be handled during the marriage. Do not wait until the night before the wedding to ask your future spouse, for the first time, to agree to and sign a Prenup. The reason is simple: courts are likely to view your last minute request, no matter how innocent, as coercion and grounds to invalidate and render the Prenup unenforceable.

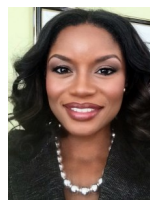
3. Postnuptial Agreement.

If you already "did" and are married, you should (or at least attempt to) take the following precautions: (1) sign a postnuptial agreement with similar terms as the Prenup; (2) keep business assets and liabilities separate from personal family property, assets, and liabilities; and (3) pay yourself a good salary from the business to help avoid (or defend against) a claim that you deprived the marital property and assets of the benefit of the company by reinvesting all the money back into the business.

4. Mediate Divorce Settlement.

If you are currently in the throes of divorce, there are still a few strategies you can attempt to do to protect your business. Instead of allowing the judge to decide your business' fate, negotiate a workable settlement at mediation. Be ready to sacrifice other assets in exchange for being able to keep the business and arrange to make payments out over time.

A Final Word of Caution: Plan Ahead. As shown above, there are a number of effective ways to "divorce-proof" your company. It is a smart idea for you to seek legal help to put the necessary agreements in place that will ensure your company's post-divorce survival. Whatever the pre-divorce preventative legal cost —e.g., as low as \$500-\$1000 for standard, non-elaborate contract preparation or modifications and added costs for more complicated and detailed versions— it is likely to pale in comparison to the lump sum amount you could be ordered to shell out in the event of divorce. Ultimately, then, it is in you and your company's best interest to plan ahead and develop a business divorce plan ASAP.



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**YOU LAUNCHED
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WE'LL HELP YOU
PROTECT IT.**

