

Beware the Empty Chair in Marital Divorce Negotiations: Company Ownership Issues Should Be Considered in Divorce Settlements

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Divorcing spouses often have a number of business issues to resolve, but one key aspect that is often overlooked takes place when divorce settlements involve the division of an ownership interest in a private company. Typically, the business is not a party to the divorce, but the absence of the company as a named party does not mean that financial or other business issues relating to the company should not be addressed by the parties in the settlement agreement. If spouses fail to consider and deal with issues relating to the company when they negotiate their divorce settlement, that may lead to adverse future results for the spouses and also for the company in the future.

This post reviews some of the important issues that spouses will want to consider when they negotiate the terms of the division of their ownership interest in a private business.

Settlement Agreement Should Confirm Full Transfer of All Rights and Ownership Interests

It sounds straightforward to confirm that whenever a spouse transfers his or her ownership of an interest in a private business in a divorce settlement (the “transferring spouse”), the documents that confirm this transfer must make clear that the spouse is conveying all interests and rights held by the spouse in the company. But, it is essential to use language that makes this clear, because an ownership interest in a private company may include many different rights, including the right to receive dividends or distributions, retirement contributions, health benefits, deferred compensation and reimbursement of expenses, among others. It is therefore critical to make sure the transfer of these interests and rights to the receiving spouse is carefully documented in the parties’ divorce settlement. The settlement agreement should therefore include language that is broad and inclusive to reflect the parties’ intent that the transferring spouse will not retain any ownership interest or rights of any kind in the company and will not receive any future benefits or financial consideration from the company or from the other spouse in the future.

Transferring Spouse Should Secure Release from the Company

It is common for divorce settlement agreements to include a mutual release in which each spouse

releases the other from all claims that existed as of the date of the divorce. It is less common, but also important, for the transferring spouse to secure a release in the settlement agreement from the company of all claims that the company may have against that spouse. A release granted by a spouse likely does not constitute a release by the company, as well, because the company is a separate legal entity, i.e., the company has its own rights that are separate and independent from the rights of the receiving spouse (the spouse receiving the transferred interest). The transferring spouse will therefore want to make sure to receive a release from the company that prevents it from bringing any claims against him or her after the divorce becomes final.

Transferring Spouse Should Also Seek Indemnity/Insurance Protection

In addition to securing a release from the company, the transferring spouse should also seek to obtain an indemnity from the company that provides protection in the event that a lawsuit is filed in the future in which the spouse is named as a party. An indemnity provision will require the company to pay for counsel for the transferring spouse and cover any liability that results in future litigation. The transferring spouse should also request that the receiving spouse arrange for the company to extend the protection of the company's directors and officers insurance (D&O) policy if one exists. This type of policy extension will provide continued insurance coverage to the transferring spouse under the policy for some period of years after the transfer takes place. This is referred to as "tail coverage," and it is generally available for a reasonable cost to the company, but the continued coverage will likely be made available only if it is requested and obtained at the time of the divorce.

Potential Non-Compete Restriction and Protection of Intellectual Property

A final point relates to the operation of the business after the divorce becomes final. The receiving spouse should consider whether the transferring spouse poses a competitive threat to the company after the divorce. If so, the receiving spouse may want to request that the transferring spouse accept some type of non-compete restriction in the terms of the divorce settlement. In this situation, the receiving spouse will likely need to provide additional consideration to the transferring spouse to compensate that spouse for accepting this restriction on future employment or business opportunities, and these terms will be subject to negotiation between the parties.

In addition, to protect the company's trade secrets and confidential information, the receiving spouse will also want to include confidentiality restrictions in the divorce settlement that apply to the transferring spouse. The receiving spouse should not be required to provide additional consideration in the divorce settlement, however, for requesting that the transferring spouse continue to maintain in confidence all of the company's trade secrets and confidential information after the divorce.

Conclusion

When spouses divide assets of their marital estate in a divorce settlement, they will want to consider issues that arise when they own an interest in a private company that is transferred to the other spouse in the divorce settlement. Specifically, the couple will want to consider issues that relate to their rights as owners of the business and also determine what is in the company's best interests after the divorce has concluded. If the couple fails to give the company a seat at the table during the negotiation of the divorce settlement, this omission may give rise to significant future problems and conflicts between the spouse that they could have addressed in their divorce settlement.

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