

THE BUSINESS DIVORCE

Protecting Your Business in Circumstances of Conflict

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Divorce is typically thought of as the legal separation of a husband and wife. Likewise, a “business divorce” is the legal separation of the owners, and thus ownership, of a privately held business entity. As with a marriage, a business divorce generally suggests serious disagreement on how the business should be run. It can also involve a lot of emotional drama similar to a marital divorce. Many different factors and conflicts can lead to the desire for a legal separation of the ownership of the business. The business divorce can be clean, or it can be messy.

Legal Considerations

Any legal process to end a business relationship will be governed by state law. The law governing the termination of the entity and the rights of the owners can be different depending on the nature of the business entity, be it a corporation, LLC, or partnership. In addition, the federal and state tax consequences regarding the division of assets can have a significant impact on how best to terminate the business relationship. There are both practical and financial issues involved, in addition to the possible emotional dynamics, that will significantly impact the separation or dissolution of a business.

Conflict is to be Expected

Even when the owners agree to part ways, they may not agree on the terms of separation, including how to resolve disagreements regarding the ongoing business operations, the valuation and terms of payment, or the ultimate disposition of the business. Because a business divorce ultimately may mean a court-ordered dissolution of a company, the lawyer advising the owner or owners must



know and understand the rights available to them under the bylaws, articles of incorporation, certificate of formation, shareholder agreement, operating agreement, partnership agreement, and/or applicable state-statutory scheme. “Dissolution” of a business does not always mean the same thing. Dissolution of the business relationship can include liquidating the business assets, the sale of the company (even to an existing owner), or a division of the company’s assets among the owners for separate ongoing enterprises. And even when the owners agree on these decisions, implementation may involve complex interpretations and resolution of murky state and federal laws.

Protecting the Business

A business owner must use the methods set out in the business entity’s governing documents, or as required or permitted by state law, to continue the operation of the business during the “divorce.” This can be particularly difficult

during a time of conflict. In most cases, one or more of the owners may want to continue in some form of the business, and that owner needs to maintain its value during this time of conflict and transition. Good relations with key employees and outside partners of the company during the transition can be critical to the continued success of the business. Obtaining prompt, practical business and legal advice is imperative to ensure that the assets of the business are not unnecessarily wasted funding litigation between the owners. Good, practical, legal advice can help avoid protracted litigation that could cause financial ruin for the business, impacting not only the owners, but investors, suppliers and customers. Without effective legal counsel, the owners and the business can be harmed, and a successful business destroyed, when the goal was to obtain a “divorce” of the owners, not the destruction of the business. ©