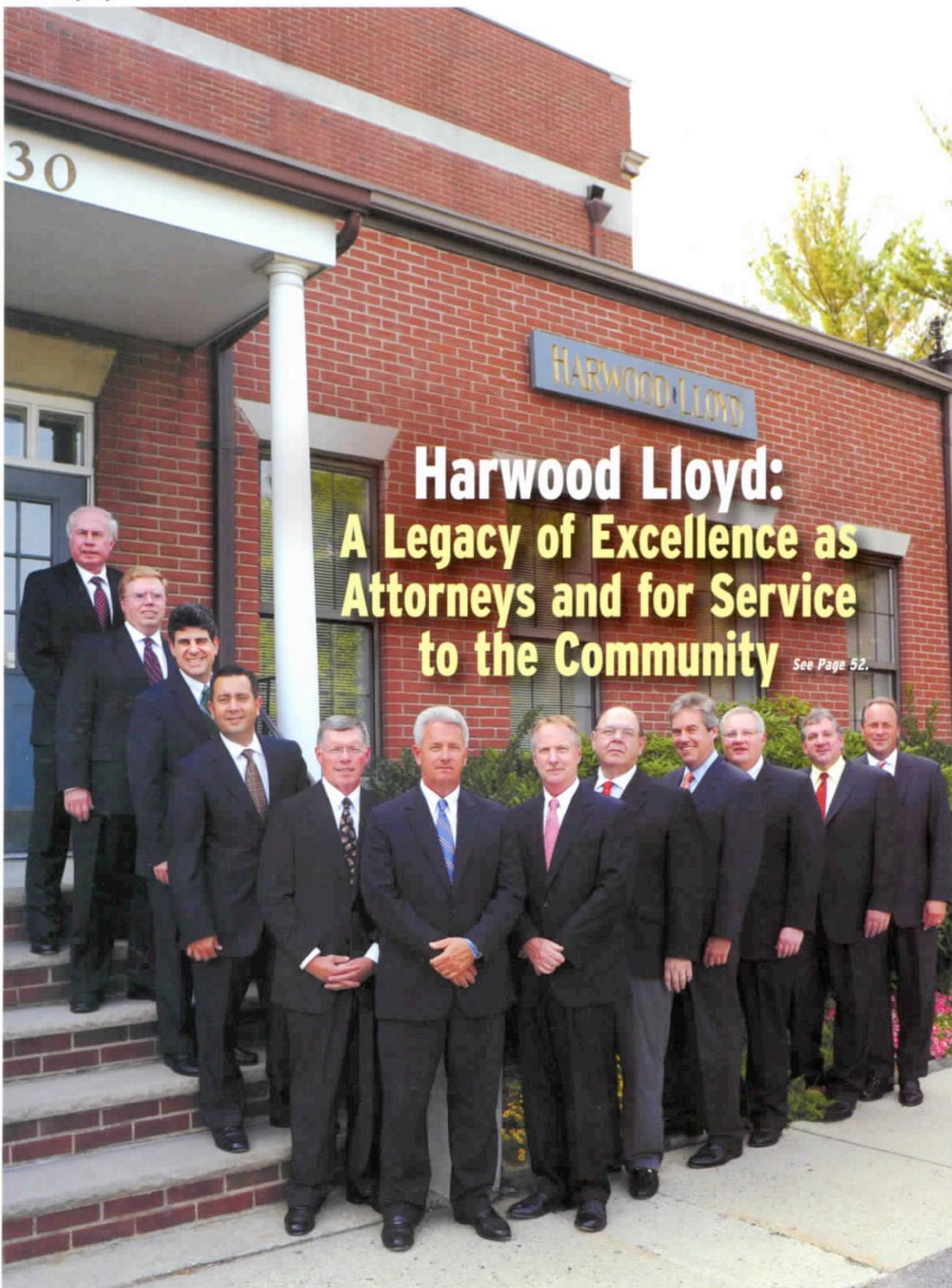


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How to Protect Your Family Business from a Divorce

The financial health of a company can be threatened when an owner's marriage is on the rocks.



By JENNIFER WEISBERG MILLNER, ESQ.
FOX ROTHSCHILD LLP

FAMILY-OWNED BUSINESSES MAKE UP AN EXTREMELY large percentage of the going concerns in this country. Indeed, some studies suggest that almost 90 percent of the businesses in the United States are family owned, and make up half of our Gross National Product. There are many issues which impact the financial health of a business, and a divorce of a principal is one event that can be particularly damaging to the company if not handled correctly. Given the percentage of marriages that end in divorce, the odds are pretty good that a divorce will affect a significant amount of family-owned businesses.

The vast majority of courts throughout the country will not force a business owner or shareholder to sell a business to pay out an ex-spouse. There is a basic recognition that a company has a greater value as a going concern, particularly when the company is a service-oriented one. Also, the distribution to a non-owner spouse is rarely equal, even in a long-term marriage. Regardless, when a divorce visits upon a business owner, things get difficult. This is particularly true when experts from one or both sides are charged with the task of valuing a shareholder's interest in the company for equitable distribution.

Many business owners are under the misconception that a business without significant hard assets can have a value, such as a consulting business, a law firm or a medical practice. Moreover, simple book value is not indicative of the true value of a company, but rather a

compilation of many factors, including intangible elements. Finding this value can be controversial, difficult and can impact the day-to-day operation of a business.

While there is no magic bullet to avoid all problems that can come with a divorce, there are precautions that can be taken to avoid common problems.

Premarital Agreements—The single most effective tool to avoid the negative impact of a member's divorce is to deal with the issue before it happens. Having a strong premarital agreement, also known as a prenuptial, or ante-nuptial agreement, signed by the business owner and his or her betrothed prior to the marriage, is the best protection later on. Certainly, pre-marital agreements are by their very nature emotionally difficult to discuss. Few couples want to talk about a divorce as they are planning their wedding. But these agreements are absolutely critical in minimizing problems later on. In the best-case scenario, a non-owner spouse will waive interest in the owner spouse's share in the company, whether it be owned prior to the time of marriage, or is anticipated to be received during the marriage. Also, any increase in the value of a business should be specifically waived.

When negotiating a prenuptial agreement, it is imperative that both parties have counsel of their own, or at least a valid waiver of the opportunity to seek legal advice, and that there is full financial disclosure by both parties. Consider making sure the agreement meets the standards of the Uniform Premarital Agreement Act,

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which may be stricter than some states' laws. This can prevent problems later on when a couple moves from one state to another. For instance, a premarital agreement that may be written in Pennsylvania may not pass muster in New Jersey. A couple who lives in one state at the start of a marriage and moves to another should consult counsel to make sure the agreement will still meet the new state's criteria. In such a case, a new, mid-marriage agreement may be called for.

Spousal Waivers—Another effective tool to keep control of the business is that of a spousal waiver. This is a

share in the event of death or divorce. Unfortunately, too often the agreements are created, and then promptly forgotten about and put away in a drawer. Yet this document can be critical in divorce court. Depending on when the parties were married, before or after the company was created, a divorcing spouse may be entitled to a portion of the value of the company, or a portion of the difference in the value between the time of the marriage and the divorce, known as the incremental increase. A buy-sell agreement with a mechanism for valuing the company that has been updated on a regular basis by an accounting or auditing firm can be the cornerstone of the valuation process.

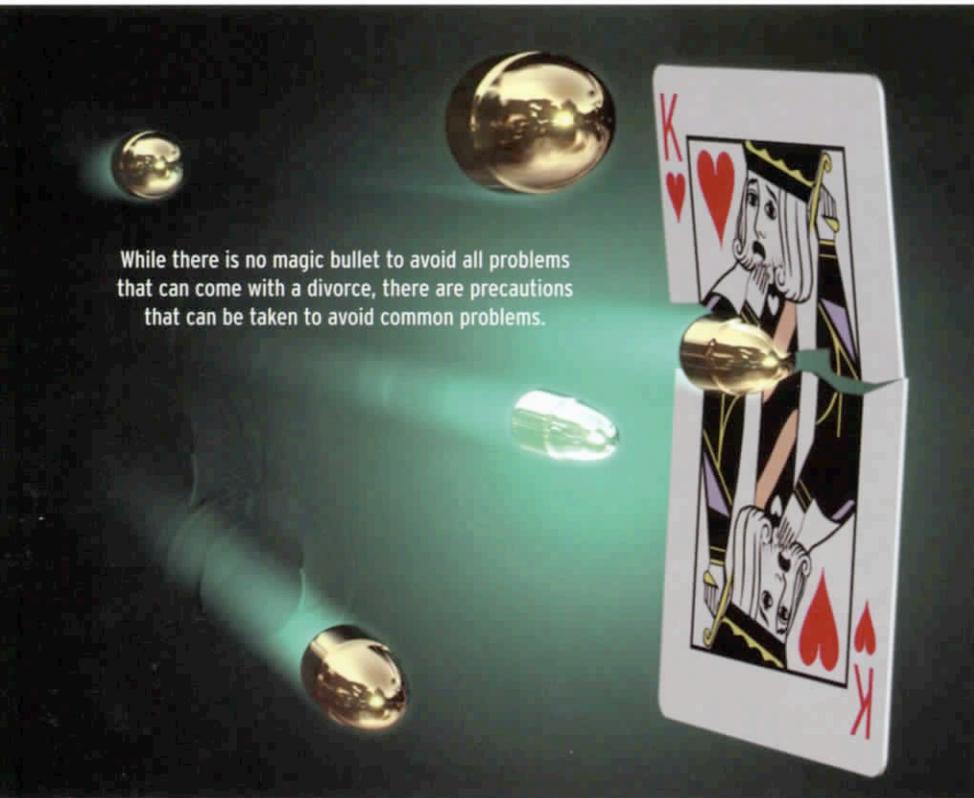
Valuation of the Business—The likelihood is that the business will have to be valued. Usually, a forensic accountant who has been appointed by the Court or hired as a joint evaluator will complete this. Sometimes, each spouse will have his or her own expert. It bears mentioning that the value of a business, in the context of a divorce, may be different than if the business is being transferred between partners, or if a minority stockholder has brought an oppressed shareholder action. In many states, minority and marketability discounts are not factored into the value for equitable distribution purposes.

Any valuation expert is going to insist on very detailed information about the company, which will obviously include reviewing several years of financial records for the company, speaking to employees and reviewing contracts that the company may have. Compensation of key employees and shareholders will be looked at carefully,

including perks. Protective orders or confidentiality agreements may be appropriate if the company deals with proprietary information. If the company is involved in a health-related field, compliance with HIPPA must be assured. These are all issues that have to be addressed.

Communication with Employees—When a divorce strikes, and a valuation of the company is underway, stress within the company can result. Accountants will be in the offices reviewing records and speaking to key non-family employees. This can cause uncertainty and fear, and even cause employees to become concerned about their job security as well as the financial health of the business. A proactive attitude is imperative in order to weather the storm. ■

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While there is no magic bullet to avoid all problems that can come with a divorce, there are precautions that can be taken to avoid common problems.

document that is signed by a spouse in which he or she agrees to waive any ownership in a company, and the spouse agrees that business decisions are to be made by the principals of the company.

Succession Planning—When a parent is transitioning from a company, there are often conditions of the younger generation receiving ownership and stock. When developing a strategic plan for the company, it may be appropriate to provide that, in order to obtain ownership, the successor family member must obtain a waiver from his or her spouse. This can serve to avoid many issues related to a member's divorce, particularly if the non-family spouse is an employee of the company.

A Buy-Sell Agreement—Update it regularly. Buy-sell agreements, which include a formula for determining a current value of a company, are often prepared at the time a business is incorporated. These agreements usually have, in addition to a blueprint to determine a partner's share, a specific plan to purchase that partner's