



CAPITAL



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What Happens When Your Business Partner Is Getting A Divorce?



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It's a typical day at the office with everything going on schedule, when your partner comes into your office, closes the door and tells you that he is going through a divorce. You commiserate with him and wish him well while in the back of your mind thinking and hoping that at least the business will carry on as usual, or will it?

The Texas Business Organizations Code (TBOC) sets forth the provisions for creating and conducting business by partnerships in Texas, as well as other types of entities. The scope of this article will include only general and limited partnerships. Texas has adopted the entity approach to partnerships. This means that the partners own an interest in the partnership, but not the particular assets of the partnership. Those assets are owned by the entity of the partnership itself. A partner may have certain rights in regard to his ownership interest, such as a right to distributions from the partnership, and management rights.

In Texas, a married partner's ownership interest in a partnership is characterized as community property if that interest was acquired after marriage, TBOC §154.001(b). If one of the partners obtains a divorce, his spouse is not entitled to an award of specific partnership assets including the partner's capital contribution and undistributed profits, which belong to the partnership and are not considered to be either separate or community property. TBOC §152.101 and, *Marshall v. Marshall*, 735 S.W.2d 594 (Tex. App.—Dallas, 1987, writ ref'd. n.r.e.)

However, a spouse's partnership interest may be included in the community property marital estate that would be subject to division in the divorce. As part of that division of the marital property, the non-partner spouse could be awarded an assignee's interest in a portion of the spouse's partnership interest. Such an assignee's interest does not include management rights, which are not subject to award or divestment, but would include a right to receive his portion of his former spouse's partnership distributions if, as, and when they are paid to the partners, TBOC §152.203(a).

The best practice is to proactively address each of the potential scenarios of what happens to a partner's interest in the event of the death or divorce of a partner or withdrawal from the partnership by including "buy sell" language in the partnership agreement which sets forth the procedure for dealing with the partner's interest, and a formula for determining the value of that partner's interest. These "buy sell" provisions should be consented to in writing by the spouse of each partner.

So upon receiving the news of your partner's impending divorce, the first place to look is at your partnership agreement. Does it contain this "buy sell" language, and specifically, does it address what happens in the event of a partner's divorce? It has been held in Texas that where the partnership agreement contained a formula for valuing a partner's interest upon death or withdrawal from the partnership, but was silent as to divorce, that the formula to be used on death or withdrawal was not binding on the court in determining the value of the interest in a divorce suit. *Keith v. Keith*, 763 S.W.2d 950 (Tex. App.—Fort Worth, 1989 no writ) and *Van Hohn v. Van Hohn*, 260 S.W.3d 632 (Tex. App.—Tyler, 2008 no writ).

As a practical matter most non-partner spouses have no more desire to be awarded an assignee's interest in a partnership than the other partners may have for that to occur. After all, the underlying concept of a partnership is an agreement between individuals who **choose** to conduct business together to do so. Instead, the non-partner spouse may be awarded some other asset from the community estate of an equal value to his portion of the community partnership interest; or if there are not sufficient liquid assets in the estate, the partner spouse could make payments to the non-partner spouse in an amount equal to that value. Which leads us to the next question: what is the value of the community property partnership interest?

If the partnership agreement is silent on that issue, then the value of that interest must be calculated for the purposes of the divorce property division, whether by agreement of the parties or by the court. The interest in the partnership as a going business (since divorce does not trigger termination of the partnership) would then be determined using accepted business valuation methods. These could include discounts for factors such as personal good will, lack of marketability, and owning a minority (non-controlling) interest. Of course, in order to conduct the valuation, the non-partner spouse would need discovery of the financial records of the partnership. This discovery could be directed to the partner spouse or to the partnership itself as non-party discovery. While reasonable discovery in these areas will be allowed, if there are issues involving trade secrets, protected customer lists, or other data which if revealed could cause a negative financial impact on the business, a confidentiality agreement or order can be sought by the partnership.

While a buy sell agreement in the event of the divorce may go a long way in addressing these issues, there has yet to be a reported case in Texas where these specific provisions have been ruled on. All in all it would seem better to have such language than not. Having it may go a long way in reducing disruption to the partnership business; however, disruption there most likely will be. The reality is that a partner going through a divorce is going to have an effect on the business, as much as everyone tries to keep it out of the workplace. Anyone going through a life changing event like a divorce will face challenges that may draw his energy and attention away from business; to what extent depends on the circumstances of each situation.

In conclusion, divorce and death are events that no one likes to think about, but when they do happen they can have a profound impact on a business partnership. Reducing the risk of the unknown is part of any prudent business plan, including addressing these events in the partnership agreement before they may happen. ■