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The Financial End of the Affair

Today's divorce lawyer needs as much business savvy as legal expertise.

By Glenn M. Cooper

Television and movies aside, the No. 1 tool of the divorce lawyer's trade is not the private eye returning to the tryst site at dawn to watch the errant spouse sneak home or snapping the fuzzy photo from afar to capture a moment of stolen intimacy. Nor does every divorce lawyer wield the instincts of a therapist and a ready supply of tissues. Today the key legal expertise needed in many divorces is a sophisticated understanding of business issues and law.

The valuation, separation, and allocation of business interests is a confounding maze of financial gymnastics, deal documents, and interlocking future arrangements. Insert those difficulties into the world of marital breakdown, often awash in ill will, and "the deal" can be very hard to complete. Over the last 20 years, here's where the business litigator who knows divorce law, or the divorce lawyer who knows business, has become increasingly conspicuous.

The one constant for divorce lawyers, of course, is that the marriage will end and the parties will soon be on their way, merry or not. But today, except for issues concerning children, the battle—defined as all that precedes the final declaration of divorce—is more often over money than righteousness. Where once divorce was the province of the church and the consequence of fault was profound, the evolved concept of marriage has made divorce more a partnership breakup with warts, a business transaction colored by emotional fallout.

While the consequences of divorce remain quite personal, those consequences are less the arena of lawyers

than of mental health professionals or priestly confessionals. Lawyers can—and should—do little more than be kind, provide some comforting words, and then turn to the real business at hand: making sure that the financial end of the affair is ably resolved. That is where we tread most powerfully; that is where we succeed or fail.

NEW RULES OF THE ROAD

So let's survey the business at hand. In law, anything less than a few score years old is relatively undeveloped land, where issues are novel and areas for imagination are evolving. The new intersection of business and divorce lacks many of the usual traffic signals.

Some 20 years ago, it was innovative to divide defined-benefit pension plans based upon a so-called "coverture" fraction, awarding the spouse's share "if, as and when" it is received by the plan participant. Today, that is the simplest of notions. Instead, we now look at the possibility of awarding a future bonus based upon the spouse's effort expended during marriage. In considering a spouse's employee benefits, we might also calculate the positive value of qualified or nonqualified options that have slipped "under water" as the company share price fell. And these are the easy issues.

Matters get far more complex when we begin worrying about valuing controlling, noncontrolling, and partially controlling fractional ownership interests in various kinds of entities. If measuring levels of control were a science and the financial market for closely held partial interests were always dynamic, this might involve a series of somewhat straightforward calculations. But measuring control is an art form, and financial markets are unpredictable on their best days. So there are many cases where the values presented by competing experts are so far apart as to cast doubt on the value of experts and even the system itself.

It is the divorce lawyers who must find and make clear the rationale for what is right. It's the lawyers who must

make meaningful the awkwardness of expert testimony. It's the lawyers who must then adequately explain it to a judge, who may know little about valuation. Failure may spell an unfair division of assets or financial ruin.

SPLITS AND SQUEEZE-OUTS

When dealing with married parties' joint ownership of operating business interests, casual knowledge of control issues will hardly suffice. What will be the consequences in a divorce case if one party, for example, forces a reverse stock split and then a merger to reduce the other party's interest to fractional shares, which must be redeemed by the corporation? On the other hand, what happens if the strategy is to proceed with the divorce case first, so there can be no consequences, and then arrange the "squeeze-out" merger?

Of course, we need to consider whether paying fair value is better than valuing at fair market value. Can we instead split the company and allocate its various parts between the parties in a tax-free divisive reorganization? Must we threaten the reverse split and squeeze-out merger in order to accomplish the split-up and tax-free reorganization? Finally, can and should we allow an "earn-out," tying a piece of the buyout to future performance? Even if we are not buying out a jointly owned interest, does it make sense to create an earn-out equivalent, tied to future performance, since value is merely an attempt to predict future performance?

In dealing with cases of significant wealth, divorce lawyers must know how to determine capitalization rates and dis-

counts, how to value vested options, nontransferable deferred compensation, and a myriad of other economic benefits and interests.

After ascertaining the apparent economic circumstances of each party, lawyers then need to apply knowledge of tax consequences and future net benefits of different kinds of financial interests—because many assets that have the same facial value are not even close in actual worth. For example, appreciated securities are

usually less valuable than depreciated securities having the same fair market value. The net value of a home may or may not be equal to the same amount of cash in the bank. An operating business in which one spouse owns an interest may, to that spouse, have more or less real value than its determined fair market value. A retirement account usually is less valuable than cash, but it may be more valuable if the timeline until retirement is long enough.

Assets are simply not equal, even if they start with the same fair market

value. And divorce lawyers are not the same as they were yesterday, even if they're all pursuing the end result of a legal divorce. Divorce is now a high-stakes business with more rules—and permutations and possibilities—than attorneys from yesteryear could possibly have imagined.

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