

How can family businesses weather the emotional and financial storm of divorce?

The Ministry of Justice has released statistics which show that there has been a sharp increase in the number of divorce applications that have been made since the last quarter, and the impact of a divorce on a family business cannot be underestimated.

The English Family Courts have extensive powers to order the sale and transfer of worldwide assets. Such powers are not limited to bricks and mortar, cash and other investments such as ISAs. They extend to the sharing of pensions and, crucially, the sale or transfer of a spouse's shares in a company. Beyond the financial consequences, divorce can have serious ramifications for other family members who own shares in a family business who may well become embroiled in messy litigation that is often emotionally and financially very expensive.

The thought of a shareholder's ex-spouse becoming a partial owner in the business ought to be sufficiently frightening to prompt family businesses to consider the protections that might be put in place to prevent such an outcome. If it isn't, then the prospect of a court battle which has the capability of being open to the press is likely to be. One only has to look at the fallout in respect of Sir Frederick Barclay's divorce to see the damage that can be done as a consequence of matrimonial litigation.

Communication and forward planning are key. Many family businesses have a strong desire to pass the company down to future generations who can continue their legacy. That will, in turn, result in younger generations becoming shareholders either during their parents' lifetime or through inheritance upon their death. It is highly likely that at any one time, such businesses may have multiple generation shareholders who may have different viewpoints about the future of the business. However, one assumes that in all cases, the shareholders – however young or old – have a vested interest in protecting the business and the value contained in it.

Whilst considered unromantic by many, pre-nuptial agreements play a fundamental role in protecting wealth on divorce – and they don't have to be fraught with difficulty. If a family business considers putting in place a policy that all shareholders enter a pre-nuptial agreement with the aim of protecting their shares (or future shares) in advance of marriage, that can materially alleviate what might otherwise be seen as a very personal (and sometimes offensive) request by the shareholder to their fiancé(e). Even if shareholders are already married, a post-nuptial agreement is an option and carries the same weight in law.

It is also worth reviewing a company's corporate documentation, such as its shareholders' agreement and articles of association. Including provisions in those documents that shares must be passed to lineal descendants only ought to act as a deterrent to the English Family Court. There may also be other measures to consider such as the use of trust structures and family investment vehicles.

Not only do such protective measures help to avoid a sale or transfer of shares, but a pre-nuptial agreement can also protect the value in those shares from being seen as "marital". What many do not realise is that if a shareholder spouse has worked in the family business during the marriage, then any increase in value of the business during the marriage is likely to be seen by the Court as a marital asset, which ought to be shared 50/50.

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Whilst this may not necessarily mean the Court will order a transfer or sale of the underlying shares, there have been many reported (albeit anonymised) cases where a shareholder spouse has been ordered to pay a series of cash lump sums to their ex to “buy out” their interest in the marital element of the share value.

The Court will require a valuation to be undertaken to establish the value of the shares at the start of the marriage vs. the value at the date of separation. If the increase in value during that period is, say, £10m, a shareholder spouse is looking at a potential £5m liability. Crucially, pre-nups can seek to limit such claims by providing that no matter what the value, the shareholding (including any increase in value) ought to be ring-fenced, thereby avoiding the need for a shareholder to be stuck with significant liabilities for years post-separation.

Plan for the worst and hope for the best would be a sensible motto and if family businesses abide by that principle, the damage limitation – in money, time and emotion – is likely to be significant.

Contacts

This document is intended to provide a first point of reference for current developments in aspects of the law. It should not be relied on as a substitute for professional advice. If advice on a particular circumstance is required please contact the lawyer listed below:



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