

Takin' Care of Business: How to Share the Business—the Business, or the Value?

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I. INTRODUCTION

This paper is intended to outline the options available to parties who must now share an interest in a business that they have contributed to during their relationship. This business is either now part of their matrimonial property, or property to be considered as part of a common-law claim. The paper will largely deal with businesses as matrimonial property, as these are the majority of cases dealt with at present, but common-law claims to businesses will be briefly addressed,

The business interest to be shared may include not only an incorporated company, which again is likely the larger number of businesses dealt with, but also a business operated as a sole proprietorship or a business operated as a partnership. This paper will also focus on the smaller, family run businesses though the case law provided is often applicable to any business. Family businesses can have many forms: the business may involve only one of the spouses, with the other spouse having limited to no direct involvement; the business may involve both spouses sharing various duties to operate and manage the business; or the business may involve extended family members and close friends, though still being considered a closely held business, not involving outside or non-arms length shareholders. Often, these extended family businesses have been in one spouse's family for generations and involve special considerations because of this.

By the time parties arrive at settlement negotiations, the value of the business will have been determined and so it will be known what there is to share. In some cases, the parties will have agreed on a value to be distributed. In other cases, an accountant working with the business and for the parties may have assisted them in arriving at a value and, in still more cases, a Chartered Business Valuator may have been retained to prepare a report on value.

II. THE OPTIONS TO SHARE A BUSINESS AS MATRIMONIAL PROPERTY

There are a number of options available to share an interest in a business. These are reviewed here in the context of settlement negotiations.

If the business is incorporated and the shares are publicly traded, the value is easily determined by the trading price of the shares, using the date agreed to as the date for settlement valuation. Parties can either then transfer shares between them *in specie* so that there is an equalization or some other distribution of the shares or, one spouse may own the shares and compensate the other for that person's share of the value either by way of a cash payment or an unequal distribution of the other assets between them. In either option, the tax impact of the choice made must be taken in

account. If the shares are going to be equalized between spouses, this generally should be done before their divorce is final, to provide for the simpler option of equalizing the adjusted cost base of the assets between the parties. Using the compensation option, the compensation for the shares must take into account the “net” value of the shares, that being the value of the shares after any calculation for a possible capital gains tax is considered. And if the shares are not going to be immediately sold by the party keeping the shares, the spouse receiving the compensation may seek a compromise on any capital gains tax rate to be applied in determining the net value.

If the business is incorporated and the shares are privately held, the sharing of this value is trickier. Is a share transfer between the parties resulting in each party owning some of the privately held shares appropriate? Or is this even possible? There may be transfer restrictions on the shares that will not allow them to be transferred and the parties cannot override these share transfer restrictions by the terms of their personal agreement, as the company is not bound by this. Possibly more important is whether the privately held corporation is a family business involving only the spouses, or whether it involves other family members or even other third parties who are not at arms length with the spouse shareholder. In any of these cases, the “clean break” principle in family law, separating the parties from continued contact with each other or ties together in a business will be an important consideration. A spouse who receives shares in a business where the other shares are held by her ex-spouse’s family will most likely be at a significant disadvantage. This possible outcome was recognized by Justice Mandersheid in the 2008 decision of *Gardner v Gardner*, 2008 ABQB 527.

In these cases, the option to share the value of a privately held business by providing compensation to the spouse who will not receive or continue to own any interest in the business is usually better than a transfer of ownership of the shares. An interesting cautionary tale can be found in the case of *D’Agnone v D’Agnone*, 530578 Alberta Ltd, *Kollias and Strojwas*, 2016 ABQB 87, a decision of Justice D. K. Miller of the Alberta Court of Queen’s Bench, reversed in part on appeal, *D’Agnone v D’Agnone*, [2017] AJ 72. The D’Agnones had been married for 34-years. They reached a settlement and signed a Divorce and Property Contract. A significant part of the assets included various companies involved in the restaurant business. As part of the settlement, the Husband was required to transfer his 1/3 interest in one of these companies to the Wife. Two close friends of the Husband each owned the other 1/3 of the shares. After the Contract was entered into, it was learned that the Husband’s two partners were not prepared to approve of the transfer of share. They and the Husband relied on an alleged oral agreement between them that no Wife or child of any of them were ever to become shareholders of the company. This oral agreement was made more concrete by the Shareholders Agreement which stipulated that any share transfer required unanimous

approval of the shareholders. The Husband did not disclose the existence of the oral agreement and represented to the Wife that he would be able to take all steps necessary to transfer these shares. The Court found several ways to compensate the Wife for the shares, including finding that Mr. D'Agnone, the company and the other two shareholders, all named as Defendants in the action, had committed the tort of civil conspiracy and had conspired together to prevent the Wife from achieving the clear economic gain she bargained for in negotiation of the transfer of the shares. A damage award in favour of the Wife was ordered and as well, the Husband was ordered to pay all costs on a solicitor/ client basis as provided for in the Contract. The Court of Appeal allowed the appeal on the finding of civil conspiracy, however upheld the trial Judge's determination that the Husband was liable to the Wife for unjust enrichment and, except for a mathematical calculation, affirmed the award of monetary damages to the Wife.

There are many forms of compensation that can be considered where shares are not transferred. Is there cash available in the business such that an immediate payout is possible? If not, can a cash payment be financed either for immediate payment or payment over time and if this is the case, is security appropriate to ensure payment over time? Should there be an interest component where payment is to be received over time? And similar to a form of compensation for shares in a publicly held corporation, perhaps the parties will want to consider an unequal division of other assets they may own to offset the value in the business?

The reality for most parties sharing the value of a small business is that one party can't afford to buy out the interest of the other party without either significantly and negatively impacting the cash flow of the business. Likewise, there may not be a number of other assets with sufficient value to be distributed in an unequal division of assets in exchange for the business interest. Because of this, a hybrid option involving both some portion of a cash payment and some portion of an unequal division of other assets may be used to overcome these hurdles. In a negotiated settlement, this option is readily available and in Alberta is also now being used by our Courts. In the *Gardner* decision the Court, in addition to recognizing that the Wife's ownership of significant shares in the business could be problematic, also recognized that the Husband may not have sufficient funds to pay the Wife for the full value of her shares. Mandersheid, J. ordered a transfer to the Wife a portion of the shares she should receive plus an equalization payment equal to the value of the remaining shares to which she was entitled.

Another option to share the value of a privately held business, where that value is primarily based on assets held within the business not critical to the operation of the company, is to put into place a corporate structure known as a butterfly transaction. Assets are equalized by a transfer of a portion