

### Beware of Ownership Differences When Dividing Marital Property

By Jerald B. Lurie

Disagreements over business assets often occur in divorce cases. Perhaps your client believes that the spouse is worth “millions” or has hidden business assets to avoid a fair disposition of marital assets.

Your task is to review and value all of the assets, and recommend which ones to retain or request – all with a minimum of legal exposure. To accomplish this, you first must identify which of the following business entities apply:

- *Sole Proprietorship*. Simplest form; Owner has full ownership; Personal liability.
- *General Partnership*. Two or more co-owners; Joint and several liability for business debts; Absent agreement, otherwise 1) Profits and losses are shared equally, 2) Equal right to participate in management, 3) Terminates upon any one partner’s death, disability or bankruptcy.
- *Regular Corporation*. Separate legal entity; Limited liability of individuals unless creditor can “pierce the corporate veil”; Management and control; Shareholders; Board of directors; Officers; Perpetual existence.
- *Close Corporation*. Less formality; Must file an election; May elect not to have a board of directors; May forego annual meetings; Limited liability.
- *Limited Liability Company (LLC)*. Hybrid between a partnership and corporation; Separate legal entity; Limited liability of members; Absent agreement; Management and control vested with members; Division of profits and losses usually corresponds to voting interest; Unanimous consent to admit a new member; Usually dissolved upon death, withdrawal, resignation, expulsion or bankruptcy.
- *Limited Partnerships (LP)*. Another hybrid; One or more general partners; Personal liability; Management and control; One or more limited partners; Limited liability; Investors only.
- *Limited Liability Partnerships (LLP)*. General partnership that elects to be treated as a LLP; Shields partners from liability.
- *Limited Liability Limited Partnerships (LLLLP)*. One or more general or limited partners; General partners are only liable to the extent provided by statute.

Next, you should examine all paper and electronic records, as well as other writings that contain the rights of the equity owners. Specifically consider the availability of tag-along and drag-along rights.

Also referred to as “co-sale rights”, tag-along rights are contractual obligations used to protect a minority owner. If a majority owner sells shares, then the minority owner has the right to join the transaction. Usually, the minority owner must elect to exercise this right in writing within a specified period of time.

Also referred to as “pull along rights”, drag-along rights enable a majority owner to force a minority owner to join in the sale if the purchaser so requires. The minority owner being “dragged” into a sale must receive the same price, terms and conditions as any majority owner.

Without a drag-along right, the minority owner can refuse to sell such interest to the purchaser. A minority owner may wish to refuse to exercise a tag-along right to prevent a sale.

To understand the impact of these rights, consider the following scenarios in which a wife has 10 percent ownership and transfers 50 percent of her interest to her husband:

- *Without a tag-along provision*, the wife can sell her shares and the husband has no right to insist that the purchaser also buy his shares. He may have no voice in how the company is managed and, consequently, have difficulty finding a buyer for his interest and be forced to sell at a discount.
- *Without a drag-along provision*, the husband could refuse to agree to a sale. This may not be problematic to the wife, unless the husband knows that purchaser is only interested in acquiring all of the interests.
- *Having both tag-along and drag-along provisions* in the agreement will prevent the wife from excluding the husband from the sale, and preclude the husband from blocking it.

Although you may be limited in securing certain economic and legal advantages for your client due to the rights and obligations imposed on the parties by the existing marital property documents, you can still plan for your client to receive at least the same treatment as the former spouse.

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