

DIVORCE AND THE BUSINESS

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Most people are familiar with the general philosophy of *The Family Property Act*. It requires that all matrimonial property (subject to certain exemptions and equitable considerations) is subject to equal division between the spouses. This rule applies equally to business assets. That is, business assets accumulated during the marriage are divided equally between the spouses regardless of who was responsible for its acquisition.

So, what's your business worth if your marriage breaks down?

There are several methods that can be used to answer that question, each with a potential to produce a different answer. You can bet the business owner will use a method that places a lower value on the business than the spouse. Ultimately the question may have to be answered by a judge after hearing from the owner, the spouse and their "experts".

One of the first issues that the court must deal with is whether the business should be valued as a going concern or on its liquidation value. The going concern approach presumes the business continues and has the potential for future earnings. This approach takes into account the potential earnings and the risks attached to earning them. The liquidation approach is simply a matter of calculating what is left after deducting the costs of liquidation, income taxes, debts, legal fees, accounting fees, shutdown fees and severance payments for staff.

To a business owner who has put heart and soul into an enterprise, the thought of liquidation may not be appealing. Applying the liquidation method doesn't necessarily require that the business be liquidated. It is simply one approach used to calculate its value. It might be the most appropriate method of valuation if the business is not viable or the going concern value is very close to the liquidation value. It is also likely to produce the lowest value from the owner's point of view.

You can look at the financial statements of your business to give you a rough idea of its value but financial statements are typically created for taxation or financing purposes and can't be relied as a sole basis upon which to value your business for division purposes.

Financial statements list the value of business assets at cost, but cost doesn't necessarily reflect the fair market value of the assets at the time of division. It may be necessary to have the assets appraised and to have the cost replaced with the appraised value in the financial statement. This provides a more realistic value of the assets.

Financial statements do not usually value the goodwill of a business either. Goodwill has been defined in numerous ways, but at its simplest it is nothing more than the probability that old customers will resort to the old place of business. Matrimonial property cases concerning the valuation and division of a business invariably involve a dispute about the value of goodwill. In struggling with the problem judges have broken down goodwill into three different types;

Personal goodwill that accrues to an individual and arises from the abilities, good name and reputation of the owner, which is not a transferable asset. Personal goodwill that is measured solely in economic terms expires at the time that the individual who enjoys it loses interest in the business, retires or dies.

Individual goodwill that accrues to a business by virtue of its employment of key individuals

whose abilities, business contacts, good name and reputation contribute to the economic well being of the business. Goodwill of this sort may be lost upon the departure or resignation of the employee and therefore has no commercial value unless the employee is prohibited from competing with the business after departure.

Goodwill that accrues to a business by virtue of its identity and the acceptance of its service or product in the minds of its customers and potential customers. Goodwill of this sort does not derive from individual employees and therefore has value and is transferable.

Goodwill plays no part in valuing a business using the liquidation approach but it may be of primary importance when valuing a business as a going concern. Accountants say that the value of goodwill is the excess of the going concern value over the value of the identifiable assets. In my view, if a business relies solely on the work and reputation of one individual there should be no value in excess of the identifiable assets. Conversely, a business that has goodwill arising from service or product recognition will definitely have additional value. The law, however, is not this definite. The courts when faced with the question have been prepared to place a value on all three types.

It is almost always necessary to rely upon the expert opinion of accountants and valuers to determine the going concern or the liquidation value of a business. There is no one preferred method and as a result there will always be an argument in favor of the owner and one in favor of the spouse. If an agreement can't be reached or the spouses can't compromise it will be up to the court to decide the fair value of the business after hearing the opinions of the experts.

If you want to avoid the uncertainty of having the courts determine the fair value of your business you should consider a pre-marriage or marriage contract. If it's too late for that, consider an agreement with your spouse for the appointment and acceptance of the opinion of one independent third party on the value of your business.

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