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Who Gets the "Baby"? (The Family Business, that is!)

by Gregory W. Herring

Small businesses are often the real "baby" at issue in family law dissolution cases. Family courts have great discretion in awarding interests in businesses that are not dependent on one spouse's professional certification or license to run it (such as a law or medical practice). If both spouses want the business, the issue becomes whether to divide it or award it entirely to one of the spouses? If the interest is capable of in-kind division, the court may so order, because that is the clearest way of achieving an equal division of the asset.

Family Courts, however, have great discretion as to whether or not to grant an in-kind division of a business.

The General Rule under *Brigden*: In-kind Division of Community Property Assets *except Where Economic Circumstances Warrant.*

A party pursuing a division of a community business would find support in the seminal case, *In re Marriage of Brigden* ((1978) 80 Cal.App.3d 380). *Brigden* established that in-kind division of marital assets is the general rule. There, the Court of Appeal reversed a trial court that had awarded the husband the major community asset – shares of stock in Logicon, Inc., a corporation for which he worked and was on the board of directors. At the time of trial the Logicon stock was publicly traded as an "over the counter" stock.

The Court held that the trial court's failure to award the wife half of the shares outright resulted in an unequal division of property in violation of Family Code section 2550. (Section 2550 provides for the equal division of community estates.) It also held that, although section 2601 provides an exception to 2550, allowing an award of one asset entirely to one party, it only applies as a limited one "**where economic circumstances warrant**." (Section 2601 provides, "[w]here economic circumstances warrant, the court may award an asset of the community estate to one party on such conditions as the court deems proper to effect a substantially equal division of the community estate.")

The Court emphasized that "economic circumstances" should be narrowly interpreted: "Equal in kind division avoids valuation problems. It eliminates the need to place a disproportionate risk of loss on either party, is impervious to charges of favoritism, and apportions the risk of future tax liabilities equally. It also accomplishes an immediate division of property and provides the parties with the most post-dissolution economic stability."

***Brigden's* Limitations:**

Blind reliance on *Brigden*, however, would not be advised. The particular facts of that case and the harsh collateral effects of the stock award to the husband were what irritated the Court of Appeal and apparently led to the decision to reverse. For instance, Logicon's value more than tripled from the time of trial to the time of appeal. The husband, as an officer, likely knew of that possibility at the time of trial. He was awarded the stock without having to provide the wife any security. He had inside knowledge as to when to eventually purchase her shares at the lowest prices.

Brigden, itself, discussed potential situations that might not warrant an in-kind division: "Though it is usually possible to divide [stock] in kind, it does not follow that it always can be done without impairment. Were the stock at issue here stock in a close corporation (Corp. Code, §158) or shown to be essential to Husband's ability to earn a living then economic circumstances would perhaps warrant the award of the entire block of stock to Husband upon conditions effecting a substantially equal division of property."

State of the Law *Circa* 2002 – 2003 (and currently): Family Courts had Great Discretion and the Fight over In-kind Divisions Turn on Whether "Economic Circumstances" Require Alternative Awards:

The same year as *Brigden*, the Court of Appeal issued its Opinion in *Marriage of Clark*, which had the **opposite** result ((1978) 80 Cal.App.3d 417).

In *Clark*, the Family Court awarded all of the shares of capital stock owned by the parties in a close corporation to the husband. Although the wife wanted half of the stock (which, itself comprised 50 percent of all the corporation's stock), the husband testified that it would be disastrous to allow the wife to own any shares because approximately 60-70 percent of the company's work was performed for a government agency that is "very conscious of everybody in the organization." The other business partner testified that he objected to any nonparticipating minority shareholders, and corroborated the testimony that the customers of the business were very sensitive to any internal conflict in the business.

The Court of Appeal confirmed that ". . . the court has the discretion to award corporate stock in a closely held company where justified by economic circumstances. . . . Here, the court was apparently impressed with the testimony of [the husband and his business partner] that the principal clients of the business might dislike a change in the stock ownership, and possibly

transfer their business elsewhere, and that [the partner] was sincere in his statement that he would close the business if [the wife] was a minority stockholder. Threat or not, [the partner], as a 50 percent stockholder, could legally dissolve [the company], and the trial judge obviously did not want to take a chance that this valuable asset might be dissipated. . . . we cannot say that [the court] abused its discretion . . . as a matter of law."

The next year, the California Supreme Court, in *In re Marriage of Connolly*, expressly limited *Brigden* to its "unique facts." (*In re Marriage of Connolly* (1979) 23 Cal.3d 590, 602.)

It reasoned as follows: ". . . [Section 2550] was intended to, and does, vest in the court considerable discretion in the division of community property in order to assure that an equitable settlement is reached. In particular cases, strict "in kind" divisions . . . may cause, rather than avoid, financial inequalities. **A spouse with a high income may be able to afford to retain high-risk assets while an unemployed spouse wholly dependent upon spousal support may not.** By dividing "in kind" high-risk assets such as the . . . stock, a court may, for purposes of fairness, divide the risk of loss disproportionately. The exercise of a trial court's sound discretion is best preserved by maintaining a maximum degree of allowable flexibility." (Emphasis added.)

A few years ago I represented the husband in a case where he argued that the wife should have been granted an in-kind division of the stock in a closely-held corporation where he was a 20 percent shareholder. In that case, the Court rejected his argument as it would have required the wife, who had primary custody of the parties' three minor children, to then sell the former family residence, causing more family disruption. On the other hand, my client argued that, without the in-kind division and the sale of the former family residence, he would be relegated to "second class parent" status, lacking the means to purchase a comparable residence for the children or otherwise maintain a lifestyle equivalent to the wife's. The Family Court could have gone either way in exercising its discretion, and it would still have been upheld on appeal.

Thus, the fight over in-kind divisions turns on whether 'economic circumstances,' as established by the facts in each case, are sufficient to justify another type of award.