Business Dealings With the Four D's: Death, Divorce, Disability, and Drug Dependency

When life throws you a curveball...

Business owners are routinely faced with unexpected situations and must be prepared to address whatever challenges come their way. Many have disaster recovery plans to address a range of issues from natural disasters to cybersecurity threats, but may be less prepared when it comes to death, disability, divorce, or drug dependency of an owner. Business owners have a responsibility to safeguard the company from these unexpected issues – whether for the near term or for future generations.

The heart of preparedness lies in well-structured operating agreements, charters, stockholder agreements, and employment contracts. Any binding document that outlines an individual's ownership stake should address the possibility that life may come with curveballs, some of which could be personally and professionally devastating.

Death in the executive suite

The death of a business owner can throw a company into disarray. In addition to the emotional toll, the death of an owner can cause disagreements among family members, loss of income to the family, liquidity issues for the business, and estate and income tax liabilities. A well-documented succession plan that aligns with the company's governing documents and the family's personal trust and estate planning can help provide a clear path forward.

Perhaps because of its finality, death is often addressed in partnership and shareholder agreements. Corporate policies are a common source of comfort, and enable companies to recoup the value of an owner's shares in the case of their death.

Disability as real as death

While not as commonly addressed, disability is a very real risk that deserves as much attention as the possibility of death.

All executives stand a reasonable chance of becoming disabled during their time at the helm. Men have a 43% chance of becoming seriously disabled during their working years and women have a 54% chance. At age 42, it is four times more likely that a person will become seriously disabled than die during their working years.[i]

Those odds are too short to ignore, especially when insurance policies are typically bought to account for an executive's shares in the case of his or her death. Similar policies can easily be attached to address disability; the additional premium is a small price to pay to safeguard the company.

Whether through insurance or shareholder agreements (or both), businesses need strategies in place to account for the disability of key executives.

Divorce can split the business

Moving from physical to emotional turmoil, divorce is an overlooked scenario that can shake a company to its core.

With almost 50% of marriages ending in divorce or separation, there is a decent chance that some executives will part ways with their spouses, yet hardly any corporate structures have default clauses for divorce. Common practice leaves the case of divorce as a personal issue to be dealt with through prenuptial agreements, which can cause an intense tug of war. Businesses cannot ignore such a clear business risk to operations and continuity planning.

The consequences of inaction can be dire, and unfortunately are common enough to make headlines on a regular basis. Consider the potentially record-breaking divorce case of Continental Resources CEO Harold Hamm. According to an exhaustive *Reuters* report,[ii] confusion erupted around the true timing of the couple's divorce, the ascension of Continental to a leadership position, and the impact a settlement would have on Mr. Hamm's role as majority shareholder.

"The firm's massive growth occurred during the marriage. Its share price has surged nearly 500% in the five years since an initial public offering in 2007," explained *Reuters*. "Under Oklahoma family law, wealth accrued through the efforts of either spouse during a marriage would typically be subject to 'equitable distribution' between the parties."

Hamm's net worth is estimated at $11.3 billion; should a significant percentage of that wealth come due to Mrs. Hamm, it could force the CEO to sell a portion of his shares and sacrifice his voting position. Should their settlement force him to transfer voting shares, the former Mrs. Hamm could suddenly become a key voting member of the company.

If Hamm's shareholder contract with Continental Resources had addressed the possibility of divorce, provisions may have been in place to ensure the company remained strong during this period of personal turmoil. As an example, a corporate charter or limited liability company operating agreement can denote that shares transferred to others automatically become non-voting shares. That way, when a divorce settlement comes due and shares go to a spouse outside the company, there will be money at stake but not control of the enterprise.

Dangers of drug addiction

Drug dependency is perhaps the least-discussed concern and one of the most likely to set a company back. Executives – especially entrepreneurs – lead high-pressure lifestyles and often have the resources to support addictive habits.

Adding to the concern, owners are generally wired to seek stimulation in some sense. As David Linden, a Johns Hopkins neuroscience professor, wrote in the *New York Times*, "What we seek in leaders is often the same kind of personality type that is found in addicts, whether they are dependent on gambling, alcohol, sex or drugs."

Dr. Linden draws from the story of Henry T. Nicholas III, a founder of Broadcom who began with a $10,000 investment and grew it into a multibillion-dollar company. "Along the way, he struggled with alcohol, cocaine and ecstasy; he entered a rehab program in 2008," wrote Linden. "For many leaders, it's not the case that they succeed in spite of their addiction; rather, the same brain wiring and chemistry that make them addicts also confer on them behavioral traits that serve them well."[iii]

Addiction is well-recognized as a disease that is treatable and temporal. An executive who fights through such an affliction will miss substantial time, and the organization will be better off if ground rules are established. Guidelines should be drafted to outline the process of bringing an owner back on board, and agreements can be structured to set aside shares for a reasonable period, offering a window for executives to right their ship. Trusts can be established to hold the shares, and certain corporate structures (e.g., LLCs can reassign them as non-voting shares until the owner returns or retires his position.

Take action ahead of the curve

Stories about corporate disarray, whether due to an owner's death, disability, divorce, or dependency, emerge routinely around the world. Giving forethought to such difficult circumstances can provide important clarity that helps companies avoid worst-case scenarios. Owners can begin by:

- Keeping it objective

The only way to effectively handle such incredibly delicate situations is to take the personal side out of the equation. To make the solutions as objective as possible, executives should deal with each of the issues individually – ideally before they happen.

Contingencies should be preprogrammed as a part of the business, with advisors on hand. In a family enterprise, the Board should be involved and the same provisions must apply to everyone. Fair standards that ensure the health of the company can be set in this manner so the legacy lives on, whether the leader falls or the next generation falters.

- Treating shares and structure with respect

Some common misconceptions are that shareholder rights are flexible and equity in the company can be treated as liquid. Shares should come with responsibility, and the right guidelines can keep that top of mind for executives.

For example, when launching a company or introducing new partners into a startup, requiring a vesting period helps ensure stakeholders are up to the task. When shares vest over three to five years, entrepreneurs have time to prove that they are committed for the long haul. This also gives time for glaring concerns to arise before vesting partners lock in their future with the company.

For a well-established business or a family enterprise, different provisions are in order. If entrenched owners are exposed to difficult scenarios, the structure can allow for their shares to be handed down a generation or set aside in a trust rather than being redistributed among other owners.

- Thinking for the next generation

Part of the solution is recognizing that a struggling or disabled executive may not be part of the organization yet. Especially when dealing with family enterprises, the reach of the company over time is likely to extend to a new and wider set of personalities. That means that a young son, daughter, or even a distant relative may grow into a leadership role 25 years after the buy-sell agreement is drafted.

The gap in time does not, however, transcend the spirit of an agreement. If terms are adopted regarding the transfer or loss of shares, the next generation of owners will simply accept them as a contractual setting. Great things (and smooth transitions) can emerge when drama is taken out of the equation decades before an incident arises.

Closing thoughts

Tragedies are unfortunately a part of life. Business owners deal with added complexity on that front, as their fortunes and families are often tied to their companies. They must recognize that misfortune comes in many forms and prepare their organization before difficulties arise. Such foresight can be the difference between a company in freefall and one that survives.

Additional resources

- Intra-Family Loans: Options for Friendly Terms in a Rising-Rate Environment
- Family Business Succession: Is the Next Generation Ready to Lead?
- Context Conflict: Preserving Goals and Values in the Family Enterprise

Endnotes

[i] *Disability Facts and Statistics,* Lifeinsure.com

[ii] *Looming divorce could threaten oil baron's empire*, Brian Grow and Joshua Schneyer, *Reuters*, March 21, 2013

[iii] *Addictive Personality? You Might be a Leader*, David Linden, *New York Times,* July 23, 2011