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Divorce in a Down Economy: Issues You Should Consider

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Special to the Legal

As I am sure everyone is aware, one of the biggest side effects of the COVID-19 mess is that the economy has taken a nosedive. Financial assumptions that were true a few weeks ago are no longer valid. On top of that, we are looking at a recession, unlike any other. Usually, by the time the economic data is available to confirm that we are in a recession, the recession is almost over. This time, however, economists can point to the second week of March, and say that is when the recession started.

Looking for the light at the end of the tunnel, unlike in 2008, when there was a fundamental flaw in the banking system that brought down the economy, this time, the powers that be made the conscious decision to choose saving lives over the health of the economy, a choice that is certainly justified. Right now, we are in a down economy because people all over the world are getting sick and dying, and our government leaders have shut down the economy to combat the virus' spread. The assumption is that when the virus passes or at least pauses, the economy will come roaring back. We all hope so, but what if it takes a while?

The intention here is to give the family law practitioner a list of issues to consider from both sides of the divorce equation, financially independent and financially dependent spouses. The list is not intended to be exhaustive, just something to get you thinking and realizing that things are going to be different, much different, in the months to come.

The number-one issue in equitable distribution, alimony and support are the parties' respective

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incomes. I have a case right now where my client has been the primary wage earner. She is in a sales job and is compensated with a modest salary plus commissions and bonuses. Her husband works for a bank and makes a stable salary with modest bonuses.

As an example, let's say that the wife's base is $50,000, but with commissions and bonuses, through 2019, her income was comfortably over $300,000. The

husband, on the other hand, has a base salary of $100,000 and bonuses of around $5,000 each year. As I noted above, the wife was the primary wage earner, but her commissions for the first quarter are going to be reduced significantly and possibly nonexistent for the second quarter. On top of that, when sales dry up, who is the first to get laid off?

The salesforce is the first to be laid off. The husband, on the other hand, has a stable job, and it should be there at the end of the pandemic. He now may very well be the family's primary wage earner.

So if you are representing the wife, what do you do? You argue the reality of the situation and how the situation has completely flipped. What may have been an equitable distribution split in the husband's favor with possible alimony to the husband, is now a 50/50 case with either no alimony or the wife receiving alimony.

From the support aspect, if you are representing the wife, as soon as she sees a significant reduction in her commissions, you file for a modification. If you are representing the husband, you argue the wife's average income over the last three to five years. It might be that the wife has experienced downturns in the past and always recovered.

As to alimony, we practitioners always like certainty in our resolutions, but maybe in these times of volatility, modifiable alimony is a reasonable idea. Modifiability can take several different forms, either a simple clause allowing modification, limited modifiability if a party's income goes above or below a particular figure, or alimony set at $1 per year modifiable up if the party who traditionally made more reaches their old income level.

In most divorces, the parties' largest asset is their house. At this point, we are too early into the economic crisis to see a noticeable effect on real estate values. So, even an updated appraisal is of no value. You have to know that the drop in real estate values is coming. Assuming there is a drop, how long will the housing market remain depressed? Who knows?

Also, demand for 5,000-plus square foot "McMansions" has been falling in recent years, so there is a question as to whether the values of that segment of the housing market will ever come back.

However, there might be value in the housing market. I have been involved in cases where one of the two parties felt the appraised value of the house represented a bargain. That party thought that he would take the risk and carry the house to a point in time where the value would far exceed the appraised amount. In relation, bad economies mean lower interest rates. While interest rates are historically low right now, they should remain that way or drop even further shortly. That means the cost of one party buying out the other and keeping the house goes way down.

Also related to real estate, this was more a feature of the 2008 recession when mortgage lending was more relaxed, but have the phone number of your local short sale specialist handy. We have not heard of houses being financially "underwater" in a while, but it could happen again, and a short sale is a way to clean up a lot of debt problems.

The discussion about real estate leads to another interesting concept. For some parties, a down economy is a great time to get divorced because everything is "on-sale." No one is buying closely held businesses, so their values are depressed, same for retirement benefits and stock accounts. Going back to the idea that interest rates are low, the cost of buying the non-owner spouse out of a closely held business also goes down.

If you are on the other side of the table, in a down economy, cash is king. Almost all of the dependent spouses I have represented are risk-averse. They like

cash. If the other side is offering a cash buyout of a house or business, think about it before saying no. Another thing to consider, I have written agreements that if the house or business sells within a designated time period for some percentage more than the divorce resolution value, an additional amount of money goes to the nonbusiness-owning spouse.

Conversely, if you are dealing with a retirement account or a stock account, avoid expressing the transaction in dollars. Language in a marital settlement agreement that one spouse gets $100,000 in retirement dollars could mean that in inflated or deflated dollars, he gets $75,000 or $125,000 by the time the transfer is completed. Express the transfer in terms of shares or a percentage of the account's value as of a date certain to ensure fairness to both sides.

Finally, any time the economy tanks, we divorce practitioners are faced with dividing up debt. Depending on the amount of debt and the proportion of debt to the overall estate, there are several approaches. The first is a cost-benefit analysis. I tell people I do not want to charge them $3,000 to get them $3,000. Similarly, how much money does your client want to spend to fight about $20,000 in credit card debt? If it is part of a $1 million marital estate, that is one thing, but if that is all there is, that is another.

If the credit card or any kind of debt is at the point where collection agencies and lawyers are involved, making deals on the debt is a second approach worth pursuing. If collection efforts have gotten that far, the creditor is willing to take your phone call to get something in the door, even if it means cents on the dollar.

The final and most drastic approach to a large amount of debt in a divorce is personal bankruptcy. This, however, can be a double-edged sword. Beware of the situation where one party files for bankruptcy, instituting an automatic stay in any divorce proceedings and later gets credit card debt discharged as to that party alone. This leaves the other party with a choice of also filing for bankruptcy or getting stuck with any joint obligations. My feeling is that in a situation with significant debt for both parties, they both file for bankruptcy or neither one files.

One final word about suggesting bankruptcy to a client is to watch out for what you wish for. If you have a receivable with that client who files for bankruptcy, guess whose debt gets discharged? Yours.

Remember, particularly in a down economy, why we got into this profession in the first place. Helping people and social justice are both well and good, but we are all in this to make money for our firms and ourselves, so be careful.

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