



Succession Success

Attorneys assist business owners with “passing the torch” to the next generation.

By Michael Silverstein, Contributing Writer

Every successful business, large and small, public and private, eventually encounters succession issues. Questions invariably arise about who will take charge if the owner or top managers are no longer around to guide the enterprise.

Issues such as these are often an even greater challenge when the business is family owned - when owners and/or managers are siblings, spouses or children of a founder. Relationship and psychological matters then become a bigger part of succession decisions. And when prudent planning and forethought have not been employed, the result can prove quite harmful - and even fatal - to the survival of the business.

How, then, should a family business owner appropriately plan for succession? How can one reduce the

chances of unnecessary conflict? What written and unwritten steps should be taken with regard to future business managers and compensation both for them and family members who are not active in the enterprise? And what role does an attorney play in meeting all these challenges?

Starting Early

“The earlier you start with succession planning, the better the outcome,” notes Robert C. Kautz, an attorney who heads the tax team at Wilentz, Goldman & Spitzer in Woodbridge. “A lot more can be done when you start earlier,” he adds. “There’s more time to take advantage of the available planning tools, and the founder has more time to control the overall succession process.”

“This process does not necessarily begin with preparation of documents,” says John R. Blasi, president, Lindabury McCormick & Estabrook in Westfield.

“In a family business, succession planning can start at the dinner table, discussing what you did that day in a positive way with family members who might one day take over the business.” Once a family member who might be interested in taking over has been identified, the grooming can begin. But “this person has to be treated the same way as an unrelated party,” states Blasi. “Paid by performance ... sticking within established reporting lines.”

A chosen successor, of course, might not always prove up to the job. Then, emphasizes Blasi, “you have to make succession plans based on business considerations. Otherwise, the succession can lead to a dramatic failure.” This sort of tough business love can sometimes be painful.



According to **John R. Blasi**, of Lindabury McCormick & Estabrook, “You have to make succession plans based on business considerations. Otherwise, the succession can lead to a dramatic failure.”

“I’ve had clients who ended up having to fire a child,” he says.

Putting It On Paper

Whether a successor to run a family business has been groomed for many years, or transition comes to the fore at a later date, legal steps must be taken to ensure the company’s future. Taking these steps is not always easy. “Sometimes with family succession,” says John D. Cromie, a partner at Connell Foley & Geiser in Roseland, “the hardest part is getting things committed to paper. There’s great sensitivity” here. But “committing it to paper is critical.”

The “paper” here is more than just some provisions in a will. “You can’t compare a succession plan with a will,” according to Victor S.

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Elgort, a senior attorney with Norris McLaughlin & Marcus in Bridgewater. A will is a limited document covering one event and the transfer of assets, he continues, while a succession plan covers other things as well. "It requires a lot more thought and implementation ... implementation in various documents." These might include buy-sell agreements, voting agreements, compensation agreements, shareholder agreements, et al.

"You're not going to do all your succession planning in one meeting," Elgort continues, "or solve or even identify all possible problems." Starting the process involves "taking a step back, getting a larger view, recognizing the goal and the possible problems."

Beyond the complexity of issues involved, there's another simple reason not to try to fit all succession-related matters in an owner's will: They might then be subject to the state's estate tax, Kautz points out.

The Attorney's Role

Most attorneys who specialize in family succession situations identify themselves as business lawyers and tend to be generalists at the bar. They have tax, estate and other legal expertise. They also have a good sense for how businesses operate, and a good feel for personal issues.

"The first thing I ask [a new client] is what will happen if something happens to you [the business owner]?" says Frank R. Demmerly Jr., chairman of Archer & Greiner's Estate & Trust Services Department in Haddonfield. "What will happen to your spouse? Who will run the business? Who will own the business, including non-operating owners?"

These are basic decisions that allow the owner to plan a succession. Then, more specific issues can be



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addressed, such as how to compensate family owners who will not end up running the business. Demmerly notes two common methods in this regard: gifting, and straight buy outs, the latter often the best choice.

Though succession planning encompasses a number of documents, says Blasi, "it all begins with the vision of the business owner. Once you have the vision you can implement

it with documents. ... The owner has to be clear about this." Clarity here, however, is often clouded by personal considerations. "Yes, there's much you can do with agreements. But with a family situation, emotion and psychology are very important, too."

One technique Elgort cites as a way to short-circuiting potential problems is to start a dialog with key members of the owner's circle - family members, key advisors and long-time employees who might not be family members - "to try to get them all to buy into the mission ... and maybe lay out some scenarios for them to consider."

Kautz cites a similar approach. "The more you can include the next generation in planning - when that's possible - the better generally is the result, with fewer unpleasant surprises."

While an attorney who helps with succession planning likely doesn't only have clients in a single industry, "a deep understanding of a particular business is a value added," says Cromie. Though every succession situation is different, "prior experience with similar [business] issues helps the client."

Flexibility

All kinds of things can require changing the succession plan of a family-owned enterprise. These include matters related to the business itself, and family-related matters such as a death, disability, bankruptcy or divorce. That's why flexibility is such an important element in this planning, says Elgort. "No good plan is unchanged over time. ... You take into account the known what-ifs, but you need flexibility when it comes to the unexpected."

The size of the family involved in succession planning doesn't necessarily dovetail with the complex-

ity of the issues that can crop up, he adds. "You can have a very tight nuclear family and still have issues - between just two children, between a wife and a child."

A succession plan is a road map that helps both a business and a family stay together, he continues. Without flexibility, problems can become intractable "and not just bring down a business, but tear apart a family."

Though succession challenges can arise in a family of any size, multiple ownership and a large family can sometimes make things dicier. Family dynamics call the shots in these situations, notes Kautz. The result? "Sometimes it can be like herding cats."

Even excellent plans with flex-



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ibility nicely incorporated don't always ensure success. "Divorce of a possible successor can [emerge as] a

big difficulty," says Demmerly. "Most times family planning is suspended until the divorce [process] is completed."

One important element of flexibility is the compensation of non-operating family members. Blasi notes a number of ways this can be achieved. These include gifting, transfer of an owner's personal assets, life insurance, etc. Bigger families often have bigger succession problems, he adds, "and may require a bigger variety of documents and legal tools."

The Effects Of Recession

Few enterprises have escaped the effects of the economic downturn. It has had an influence on many kinds of business planning. Dem-



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merly opines that if the basics of a succession plan (its objectives) remain unchanged, the economy need not change family planning all that much.

While agreeing that changes in the economy don't change a plan's fundamental goals, Elgort says that such changes can put a higher premium on some plan elements. A successor, for example, "might need a higher level of skills. ... What might have gotten him by in good times may not be enough today."

Periodic reviews of a succession plan may find that the value of a business has diminished, which could make it harder to equally compensate family members, says Blasi. Some owners, of course, "have the philosophy that this is the risk that family members take." Others may cut back in allocations to some family members because they think "they now have to take care of themselves and their spouses."

Not all aspects of the present difficult economy are actually bad for succession planning. Part of many of these plans is to sell the business to a successor who pays with a promissory note. "These notes have to be at prevailing interest rates to satisfy the IRS," notes Kautz, "and these rates are today at historic lows."

Conclusion

Keeping a business under family control has never been a simple matter. Legal complexities have to be addressed, and personal and generational disagreements must often be finessed.

With prudent succession planning by a business' founder, and wise outside counsel, however, the goal of keeping a business a viable and successful family-owned enterprise can be achieved long after its founder has transferred control. NIB



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