

## KEY CONSIDERATIONS FOR A SUCCESSION PLAN

### The Key Documents:

- Shareholder Agreement, Member Control Agreement, Partnership Agreement (with buy-sell and management provisions)
- Wills or Trusts of the Principals
- Articles of Incorporation and Bylaws, Articles of Organization and Operating Agreement.

These should all be integrated or complimentary, in a well-designed succession plan.

*Firming Up Plans and Setting Expectations.*

*Planning For the Unexpected.*

*Determining Who Has Input and How Much.*

*Suggestion: Bring in the next generation with some ownership at the time the plan is put in place, so they are parties to the shareholder/control agreement from the outset.*

### Future Management:

- Designate Successors to key offices (CEO, CFO, COO, Managing Partner)  
*Who are the key employees or control key relationships/customer loyalties.*
- One, or a few collectively, holding controlling shares, but with super majority approval required for certain actions, expenditures, loans, etc.

*The Importance of Checks and Balances.*

*The Importance of Having People Who Can Make Decisions Day to Day.*

*The importance of retaining some 'veto' authority if you are financing a buyout.*

### Consider Future Risks and Rewards:

*From the perspective of both incoming and outgoing owners.*

- Loans & Sureties-Generally, lenders and sureties want anyone holding 10%-25% or more in equity interests to sign all guaranties/indemnity agreements.
- It is important to consider whether non-controlling (and/or inactive) shareholders or members should be put in the position of having to either risk their own assets on a venture they do not control and/or are not involved in, or hamstringing those who are.

*How Will You Tie Risk, Reward, and Authority Together.*

*Spelling That Out for Those on Their Way In and Up, and Those on Their Way Out.*

### Buy-Sell Provisions:

- Buy-out provision are key; those who will be active and/or in control need the ability to buy out those who won't be.  
*They are the ones who will be putting their own assets and credit at risk.*

- Those who won't be in control or active may also want or need the ability to 'put' their interest to the company or active parties.  
*They are the ones who may be finding themselves dragged into an adventure they didn't sign up for.*
- Involuntary Transfers; Sale Restrictions; Other 'Un-invited' Guests.  
*Divorce, Death, Disability, Bankruptcies, Creditors, and the unapproved sale.*
- Terms and Timing: Open-ended option, or window; payment terms; security.
  - Who will be the buyer, i.e., the company or the other principals, or does one or the other have a right of first refusal or secondary option?*
  - If the buyers are the other owners, there can be significant shifts in control if some participate while others don't.*
  - Security: Stock, Membership Interest or Partnership Interest, remedies if there is a default (such as reversion of voting rights and rights to distributions, etc.), or Assets of the Company (BUT: Consider demands of primary and other lenders, effect on flexibility for future financing; or, consider limits on encumbrances and the requirement of a waiver from the selling principals to go over those).*
  - Future cash flow needs, ability to fund the buy-out.*
  - Life and disability insurance as funding source.*

*These things are typically all spelled out in the Shareholder, Member Control, or Partnership Agreement.*
- *Consider conditions to purchase option or forced sale, in particular release of guaranties and indemnity agreements.*
- *Consider discounted pricing in some instances-such as giving key people less if they don't agree to competitive restrictions.*
- *Consider 'earn-outs'; i.e., part of the redemption or buy-out price is dependent on future results, particularly if it is a 'key' person who is leaving.*

#### Buy-Out or Redemption Price:

- The threat of the 'runaway' or 'low-ball' appraiser; i.e., why just specifying a 'fair market value' price can be dangerous.  
*Example: The use of formulas, such as an adjusted book value, with certain assets marked up or down to current value, and a factor for good will; consider capping the factor for goodwill (such as some multiple of EBITDA), and be sure to factor out regular salaries and bonuses, i.e., a buyer shouldn't be buying their own job, at least to the extent their compensation is reflective of what they could get working for a third party without the risks of ownership/guaranties/indemnity agreements, and sellers can't expect a factor for what they would have earned as salary or bonus had they continued, as that will now have to be paid to someone else (and the seller won't be providing those services anymore).*
- Consider that the future growth will be largely a result of the efforts of those active in the business.

#### ESOP's and other forms of Employee Stock Ownership; Future Sale:

- The importance of 'tag-along' and similar provisions, in particular when considering the future ability to sell the company or the assets.

*Most third-party purchasers (be it assets or stock/equity interests) see the ESOP as a burden to be closed out by the seller.*

- Some alternatives to Qualified ESOP Plans.

*An individual incentive stock or stock option agreement, with a vesting schedule and the ability to buy back the 'vested' interest.*

*Phantom Stock.*

- Other considerations for future stock or asset sale (marketability, etc.).

*Tax implications of a sale of assets v. a sale of stock*

*In addition to the tax implications, keep in mind that the assumption of fixed liabilities (i.e., term loans, purchase money loans, leases, etc.) is much more palatable to a buyer than assuming warranty and tort liabilities-which is generally the case when they buy stock or membership interests.*

*Buyers are generally going to be asking for representations and warranties, and indemnities against liabilities during the seller's period of operation; consider 'tail' insurance coverage.*

#### Closing:

- Work for harmony, but plan for dissension.

*Have a path, but build in flexibility for course corrections along the way.*

*Consider whose approval will be necessary to make changes.*