

Succeeding with Business Succession Planning

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Business continuity planning, or succession planning, is a consideration often overlooked by owners of small or new businesses, who may be consumed with the business's day-to-day operations. The issue comes to the forefront, however, when a business is faced with an unexpected interruption, such as a natural disaster, when a business partner suffers disability or death, or when business partners desire to separate.

While appropriate business interruption and other general commercial liability insurance can often accommodate short-term interruptions such as weather events and power outages, a partner's death, disability, or a decision to leave the business, without proper planning, can threaten the viability of the business and its value to other partners or members.

Most succession issues can be addressed through a buy-sell agreement between the business owners, which may be incorporated into a company's shareholder, partnership or operating agreement. Generally speaking, these agreements may provide two basic options when a partner dies, becomes disabled, or wishes to leave the business: that partner's successors may assume his or her ownership interest (and control) in the company, or the company (or remaining owners) may purchase that partner's interest (assuming sufficient funds are available).

Introduction of family members, who may or may not have experience in operating the business, as shareholders or partners poses substantial risks and drawbacks, making it preferable in most cases for partners to agree that the company will purchase a deceased, disabled, or exiting member's interest. (The buy-sell agreement may also prohibit transfer of ownership in the company to other individuals or entities who are not currently involved in the business, similarly avoiding the practical problems of disinterested or uninformed owners.) The questions then become (1) how will the parties determine the company's value? and (2) how will the company fund this purchase?

A buy-sell agreement gives the parties an opportunity to agree on how value should be determined, and also gives the parties the advantage of planning for financing such a purchase, i.e., through life insurance proceeds payable to the company. In addition, early planning through a buy-sell agreement allows partners to fully evaluate the tax consequences (including estate tax consequences) of various buy-out arrangements, i.e., redemption (purchase by the company) versus cross-purchase (purchase by remaining owners). Estate tax concerns are also

implicated when life insurance owned by a partner, as opposed to an entity, is used to fund a buy-sell arrangement.

A buy-sell agreement is invaluable in the event that one partner decides to leave the business. Not only does the agreement provide for how value should be determined, and how the partner's interest should be redeemed (i.e., by lump sum versus installment payments, or purchase by the company as opposed to purchase by the remaining owners), but also a buy-sell gives the partners an opportunity to include other restrictions on an exiting partner, such as non-competition and confidentiality. To be expected, it is much easier to negotiate the terms of a business "divorce" *before* the divorce is impending. Think of it as a "pre-nup" for your business.

Although it is impossible to predict *when* your company will need a succession plan, it is easy to predict that your business *will* need a succession plan. The time to act is now – once you realize the value of a well-drafted buy-sell, it may be too late. Be assured that if you do not negotiate and prepare your company's buy-sell agreement, state law will essentially create one for you, the terms of which may be neither desirous nor advantageous to you.