

Introduction

This book is written for lawyers who represent family businesses and their owners, but this material can be read, understood, and used by family business owners and their other key advisors. The purpose of this book is to provide lawyers with a complete, thoughtful, step-by-step approach to family business succession planning. While the book is structured for family business succession planning, it is not just an organizational tool. Each part of the book also provides substantive guidance, insights, and resources that will help lawyers advise the owners, design the structures, and draft the documents to produce an effective, appropriate, and thorough succession plan for a family business.

The Case for a Family Business Succession Practice

A lawyer who practices in the areas of business law or estate planning and works with closely held companies or their owners can substantially enhance his or her practice (while making a positive impact on society) by developing the ability to assist family businesses with their succession planning needs.

The market for family business succession planning is vast. Some sources report that almost 90 percent of private companies in the United States are family owned,¹ and family businesses may be uniquely constituted to compete for market share going forward.² Even if the target client for family business succession planning is defined as a subset of family businesses, the number of potential clients is huge. Family businesses that are owned by the founder or a descendant of the founder with plans to pass ownership of the business to another family member may constitute up to half of all U.S. businesses.³

Family businesses are chronically underserved with respect to succession planning. According to a 2017 survey by PwC, 44 percent of family business respondents said that succession would be a major challenge over the next five years, and only 23 percent said that they had in place a robust, documented succession plan.⁴ These numbers are consistent with what family business lawyers typically observe. Although family business owners are often blamed for this deficiency, their advisors also may be at fault. At least, in many cases, business owners cannot engage in quality succession planning unless their advisors lead them through the process. If the lawyer for a family business can offer a succession planning process that is well-organized, systematic, and presented in a way

1. JOSEPH H. ASTRACHAN & MELISSA CAREY SHANKER, *Family Businesses' Contribution to the U.S. Economy: A Closer Look*, FAM. BUS. REV. 16.3 (2003) at 216.

2. See, e.g., Josh Baron, *Will the 21st Century Belong to Family Business?*, HARV. BUS. REV. (March 28, 2016), available at <https://hbr.org/2016/03/why-the-21st-century-will-belong-to-family-businesses>.

3. ASTRACHAN & SHANKER, *supra* note 1 at 216.

4. PwC, "THE MISSING MIDDLE: BRIDGING THE STRATEGY GAP IN US FAMILY FIRMS," (2017) at pg. 14. (A copy can be obtained at <https://www.pwc.com/us/en/private-company-services/publications/assets/pwc-family-business-survey-us-2017.pdf>).

that lay people can understand, most family business owners are appreciative and committed to engaging in thorough succession planning. This book will help enable lawyers to offer that kind of process.

Competition in this practice area is slight and often ineffective. The conventional opinion is that family business owners will not engage in succession planning because they are too busy, or they do not want to face their own mortality, or they want to remain indispensable, or it is too difficult. Many lawyers seem to accept these narratives and then create a self-fulfilling prophecy by ignoring the succession planning need in the market. In most cases, however, the only true impediment to family business succession planning is that it is too difficult for the owners to do it without the guidance of a proper advisor. Unfortunately, lawyers who have been discouraged from committing to a family business succession practice may not have the skills or experience to provide the necessary guidance. These lawyers may approach family business succession planning on an ad hoc basis, often providing services that are limited by a practice silo, such as estate tax planning or business organizations. This book will help lawyers provide guidance for succession planning that addresses all of the relevant legal practice areas and thus will help remove many of the difficulties that prevent family business owners from addressing their succession planning needs.

Family business succession planning can build a strong, broad, and lasting relationship between lawyers and clients. Family business succession planning, of necessity, allows a lawyer to engage with the highest levels of decision makers in a family business, often on a very personal level. Therefore, if the lawyer's firm provides other legal services for businesses, it is natural that a relationship built on these foundations would allow the family business lawyer to offer the assistance of his or her colleagues in other practice areas as the clients' other legal needs may arise. Family business succession planning also can create a relationship of trust between the lawyer and the next generation of owners and managers. As a result, a lawyer's relationship with a client built on family business succession planning may last the lawyer's entire career.

Representing family business clients and helping sustain their success is a worthy pursuit. By some measures, family businesses produce more than 60 percent of U.S. gross national product and employ more than 60 percent of the U.S. workforce.⁵ The values and sense of mission with which family businesses are imbued can produce better products and services and can provide a more rewarding place for talented individuals to work.⁶ Family businesses can be great citizens in their communities,⁷ and many family business owners generate goodwill for their businesses and cohesion in their families through the use of private foundations and other charitable giving projects.⁸

5. ASTRACHAN & SHANKER at 217.

6. See, e.g., Baron, *supra* note 2; according to the advocacy group Family Enterprise USA, family businesses generate 64 percent of U.S. GDP and account for 65 percent of domestic employment, and 78 percent of new job creation stems from family businesses (<http://policyandtaxationgroup.com/estate-tax/family-businesses-jobs-economic-activity-and-charity/>).

7. On a 2018 survey conducted by the Policy and Taxation Group of Family Enterprise USA, respondent family business owners on average made 79 percent of their charitable contributions to local charities, available at <https://policyandtaxationgroup.com/estate-tax/2018-family-businesses-survey-reveals-commitments-challenges-concerns/>.

8. See, e.g., Charles Paikert, *Stepping Up at Family Firms*, N.Y. TIMES (Nov. 8, 2012).

In summary, a lawyer can establish a lifelong practice that is rewarding, both personally and professionally, by helping family businesses create, maintain, and implement a succession plan for ownership and management using an approach like the one described in this book.

How to Use This Book

This book is organized as an outline of a business succession project from beginning to completion, roughly in sequential order. Note, however, that many of the topics or tasks are interdependent, and therefore each section of the outline should be considered or anticipated throughout the project.

The book explains a particular, step-by-step process for family business succession planning. If a lawyer reads the book from start to finish, he or she should develop a very good understanding of how family business succession planning can be organized and accomplished. Each section explains key concepts, identifies issues that need attention, suggests one or more approaches, provides practice tips, and, when needed, refers the reader to other resources for further assistance on a particular task or substantive subject matter.

In addition, lawyers can refer to particular sections of the book to supplement their thoughts on a particular topic, provide instruction to colleagues or staff, or copy language that can be used to explain a concept to clients and their other advisors. The primary target for the process described in the book is a business that is owned by one or more family members who intend to pass ownership of the business to one or more of their descendants. However, many of the book's sections are relevant to business owners who may be considering an alternative disposition of their ownership interests. For example, many of the sections can help a lawyer assist business owners who plan to sell their interests to non-family insiders or who have not yet decided on a particular exit strategy.

This book provides a template for the lawyer. A family business lawyer may use the structure of this book as an outline for a family business succession project to help guide and organize the lawyer, the lawyer's staff, the business owners, and the business owners' other advisors. At the beginning of the representation, the lawyer may draft an outline of the project in the form of a memo, such as in a form similar to appendix A. Then, from time to time, the lawyer may update the memo as he or she and the business owners focus their thinking about the project, make key decisions, and complete particular tasks.

This will keep the project organized and will better coordinate the efforts of the various people working on the project. It will help the business owners understand the whole project and the importance of each element of the project in context. It also will help the business owners budget the time and financial resources needed to complete the project. Finally, it will help the owners appreciate the work that has been accomplished throughout the course of the project, particularly in proportion to the time and money spent.

As the family business succession project develops, the lawyer and his or her staff also can create a checklist, in a form similar to appendix B, to further enhance organization and efficiency. This tool translates the business succession planning outline into a specific list of tasks and documents for each part of the project, including the name of the

party responsible for the task or document, the projected or effective date of the task or document, and the individuals who need to sign the documents to give them effect.

Sections 2.3.6 and 2.3.7 discuss in greater detail how to create the project outline and checklist, and subsequent chapters provide specific material for the outline and the checklist.

This book applies to a range of owner exits. This book will be most helpful with respect to businesses that are family owned and operated, particularly if the controlling owners intend to transfer ownership to successors within the family. However, even if the controlling owners have decided not to keep the business in the family, or if they are undecided about successor ownership, many of the tools and insights provided in this book will help the family business lawyer work with the controlling owners to plan their exits and the next stage of their family's economic collaboration. For example, if the business is to be sold to a buyer outside the family, this book contains material that will be helpful to sellers who intend to use the sales proceeds to transition to new family ventures, a collective family investment vehicle, or a family office. Similarly, this book will be helpful if the controlling owners are considering a transfer of ownership to a group of non-family insiders or even an employee stock ownership plan.

Key Concepts and Highlights

A few comments about key concepts and the foundations of the approach described in this book will help put the subsequent material in the proper context.

This approach to family business succession planning is based primarily on good business governance. The core of this book is about designing business governance structures that will apply to successor owners and managers, and then establishing contractual relationships and estate planning mechanisms that are consistent with those business governance structures. This book gives priority to governance, because governance can have a great impact on the immediate profitability of a business, as well as on stability in transition, success of future managers, and value for future owners.

This approach also emphasizes providing mechanisms for future owner exits that are fair and not disruptive. Some successor owners, particularly those in the minority, may wish to exit ownership and use the value of their interest for other purposes. A good family business succession plan will include a comprehensive buy-sell agreement with mechanisms and procedures for minority owner exits that are fair to the exiting owner but do not impair business operations or necessary growth.

This approach does not lead with estate tax planning, but it makes estate planning much more effective. After the lawyer has helped the client design governance structures and exit mechanisms that will apply to successor owners, it will be much easier for the present owners to decide how to allocate their ownership interests in their estate planning and to engage in strategies to manage estate taxes that do not create a cause of controversy among successor owners and other estate beneficiaries. This approach, however, also adopts a cautious attitude toward lifetime wealth transfers to avoid leaving current owners with a diminished quality of life as a result of overly aggressive estate tax management techniques.

This approach to family business succession emphasizes the use of rules, process, and structure, rather than trying to dictate substantive results. This means two things.

First, this approach attempts to create well-defined ownership and governance structures to enable owners and managers to make good business decisions, but it does not attempt to dictate what those business decisions might be in substance. Similarly, this approach is intended to create equitable governance structures and well-defined ownership rights that help avoid acrimony (or at least litigation) among successor owners who may have discordant personalities, incompatible value systems, or conflicting interests and objectives, but it does not involve a substantive exploration of family dynamics, family history, or individual psychology. Under this approach, if successor owners disagree about the business, regardless of the individual emotional or personal historical causes, they will have equitable means of resolving those disagreements and a structure for co-existing as owners, or they may exit ownership on terms that are fair to them and the other owners.