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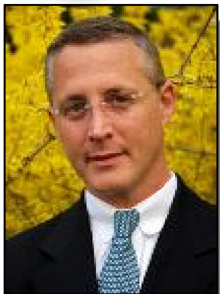

Business Continuity Planning:

IS YOUR CLIENT'S BUSINESS (OR YOUR OWN PRACTICE) REALLY PROTECTED?

BY JEFFREY A. KERMAN AND MARK W. McGORRY

Let us start with an important *fact*: one day every business owner (and lawyer) will leave their business. Yet quite often owners give little serious thought to just how they will do that. Owners leave for a variety of reasons, and simply want to do so with their "*fair share*" of the value of the business. Prior planning is the key to accomplishing this "*fair share*" goal.

Very few business partners begin working together with an expectation of future animosity, much less litigation. Yet over time, in business as in marriage, partners can grow apart, precipitating a "divorce". We have all likely witnessed this in some form. Business divorces can be equally unpleasant (or even worse) than the break-up of a marriage. A business owner may be *unable* to leave the business, or force a partner (or their heirs) to leave, without appropriate tax and legal planning. What will really happen when you or a co-owner/partner wants out with a "*fair share*"?

Business Continuity Planning encompasses a wide range of consequences that may follow the departure of an owner or a member of a controlling ownership group because of death, disability, retirement or termination. The purpose of this article is to stimulate thought that leads to *actual* business continuity planning, not only for your business owner clients, but within your own law practices. Let's discuss…

BUSINESS CONTINUITY PLANNING – WHAT IS IT?

Business Continuity Planning protects the owner's right to receive payment for their interest, provides certainty about what they may be required to pay for the interest of a co-owner, and supports the business after an owner's departure so that the business can continue to thrive as an ongoing entity.

Business owners can generally benefit from the Business Continuity Planning if they:

1. Are no longer comfortable with the "*unwritten understanding*" that they have with their partner(s) about what they would do if one of them dies;
2. Believe that their spouse would be incapable of running the business if the spouse/owner involved in the business were to die or become incapacitated, or
3. Wish to protect the income stream that supports their family should something happen to them.

IF THE STATEMENTS ABOVE APPLY TO THE BUSINESS OWNER'S SITUATION, THE NEXT STEP IS TO ASK THEM:

- Do they want to give themselves the best chance to receive their full value for their ownership interest if certain events were to occur (such as death, disability or retirement)?
- Do they want assurances that they will pay fair value if they are the ones required to purchase the ownership of a co-owner?
- Do they want to put a written structure in place so that the business can stand on its own, be financially independent from the owner, and continue to thrive after the owner is gone?

PLAN BEFORE THE CRISIS OCCURS!

Business continuity issues can be divided into two camps: those that occur while the owner is healthy, and those that arise upon the owner's disability or death. For example, in the case of transfers during an owner's lifetime, they may have the luxury of time to find and to train their replacement. This is not ***always*** so in the case of disability or death. For the company to survive:

1. The company must have adequate cash (almost always subsidized by life insurance)

2. Continuity of Business Ownership
3. Company's Loss of Financial Resources
4. Loss of Key Talent –You!
5. Loss of Employees and Customers.

Immediately after the death of an owner, in the short run, money may be required to:

1. Effect a buy-out;
2. Provide capitalization;
3. Replace the balance sheet with respect to lenders, and
4. Provide cash incentives to entice your employees to stay.

BUY-SELL AGREEMENT: DON'T SET & FORGET IT!

Any article on Business Continuity Planning should discuss the use of a Buy-Sell Agreement. Your first step toward avoiding the problems described in this article is to conduct a thorough review of your business continuity agreement. Chances are that when you turn to your Buy-Sell Agreement (if one even exists), you will find that it is usually out-of-date.

You may also find that the agreement controls the terms of your (or any owner's) exit from the business not only upon death, but also during lifetime. It is very difficult to gain agreement on provisions when the buyer and the seller are at the bargaining table due to a crisis. They need to agree on and document the business valuation, payment and tax provisions long before potential discord or differences of opinion arise. If you have not looked over your Buy-Sell Agreement since it was signed, dust it off and check out at least four (4) key must-have provisions:

1. Lifetime and Death transfers of ownership:
    - When must an owner sell, or offer to sell?
    - When is an owner (or the company/practice) obligated to buy another's interest?
2. How will the value of the company/practice and the value of a departing owner's interest be determined?
3. Does the agreement mandate the use of an independently determined Fair Market Value at the time of transfer? If not, the valuation will favor either you or the other owner. It will not treat you even-handedly.
4. What are the terms (length, down payment, interest and guarantees) of the buyout?

Practice Note: Although the Buy-Sell Agreement is not the "be all, end all" of Business Continuity Planning, we generally assume that they control the transfer of an owner's interest when he or she dies or becomes disabled. However, the planning that goes into these agreements is critically important. Don't wait for the crises…start the planning now.

POSSIBLE STRATEGIES USED IN BUSINESS CONTINUITY PLANNING:

The Buy-Sell Agreement is not the only strategy to consider. Owners can implement any combination of the following value protecting strategies, including, but not limited to:

- Business Insurance for Continuity Planning
- Create Business Continuity Guidelines
- Wage (Salary) Continuation Plan
- Retaining Key Employees After Death or Disability
- Stay Bonus Plan (for current employees)
- Plan for Financial Independence of the Company

IN CONCLUSION

In the long run, an owner can exit their business/practice in style with their "*fair share*", or not. If you (or your surviving family) want your "*fair share*", you must take action. The benefit of starting Business Continuity Planning today is that you will be building value within the company or practice that may be available when you leave. The time for action is now.

Please feel free to contact the authors with any questions, comments or things you would like to talk about.

Mark W. McGorry, JD, CFP, CPC, CLU, AEP is a financial advisor who assists clients with the accumulation and distribution of assets in a tax informed manner. His education includes a J.D. from Fordham University School of Law and a "Master of Science in Financial Services" from the American College. He regularly works alongside clients' other advisors to develop, design and implement advanced planning strategies.
Contact: MMcGorry@WealthPartners.com

Jeffrey A. Kerman, JD, CWS is a financial advisor and Certified Wealth Strategist who utilizes investments and insurance planning strategies to assist clients in accomplishing their financial and estate planning goals. As an independent advisor, he offers securities through First Allied Securities, Inc., a Registered Broker/Dealer, Member: FINRA/SIPC.
Contact: JKerman@WealthPartners.com