Ownership Transition

Passing the Torch without Getting Burned

By Kevin R. Sido and Todd M. Young

Structural engineering and other design firms depend upon their professionals for survival. The loss of even one owner can lead to turmoil at the least and dissolution of the firm at the worst. Proactive succession planning can help firms fend off those worst-case scenarios. In the process, succession planning can help senior owners realize that they won't want (or be able) to work forever, and that they need a buyout from the younger engineers just as much as the younger engineers look forward to their turn at ownership and management.

Are You Ripe for Ownership Planning?

Every closely held firm can benefit from ownership transition planning. But if your firm has any of the following attributes, you could be particularly ripe for the process:

- Ownership is concentrated in a sub-set of professionals at the firm, especially individuals of a similar age.
- Younger professionals have expressed a desire for ownership and participation in firm governance/strategic planning.
- Certain equity owners have expressed a wish to reduce workload and/or focus on non-revenue-producing activities (mentoring, strategy, life-balance, etc.).
- Firm management has realized a need to provide incentives to a sub-set of non-owner professionals, to encourage them to develop business on their own.

Risks in Succession Events

Like most complex endeavors, ownership transition events are not without risk. There are management risks (*Are we promoting and giving ownership to the right people, and are we reducing ownership interests of the right people, too?*). There are also business risks (*Will the clients have concerns when they learn of the shifts in ownership?*). And there are financial issues to consider (*If the succession model involves having the firm repurchase equity from certain owners, will the firm be able to afford the repurchase price?*).

Regulatory risks also arise. State regulations on the practice of engineering may specify how the firm can be named, owned and managed, often requiring all or a percentage of the current owners, directors or managers to be licensed professionals. Firms must prepare succession plans with an eye on continued compliance with licensure rules.

Employment Law Risks

An important source of risk in ownership transition involves employment laws. Succession planning involves making distinctions between senior owners and younger professionals, and those distinctions often involve reducing ownership in the senior group and increasing it in the junior group. Federal and state employment laws generally take a dim view of treating older people less favorably than younger ones for age-related reasons. Thus, a critical piece of any succession plan is an analysis of employment law concerns.

Many professional firms have an explicitly age-based succession plan hard-wired into their operating documents (such as a Shareholders Agreement or Bylaws). Those plans often require equity owners to sell back their equity in the firm at a specified time, determined in relation to the owner's age. Recent case law and EEOC administrative proceedings have raised the possibility that some of these provisions constitute age discrimination, exposing firms that have those provisions to liability. Even if these provisions are drafted to apply only to professionals who are equity owners of the firm, they may still expose the firm to damage claims and challenges to the enforceability of the provisions. Happily, there are creative solutions that can provide the desired incentives while staying on the right side of the employment laws.

Whom to Involve?

In creating an ownership transition plan, it is essential to assemble the right team of professionals. The firm's attorney and tax accountant are key players. Outside lenders, valuation firms and succession planning consultants can provide assistance as well. Estate planners for the affected professionals will have important guidance to share also.

We sometimes add (only half jokingly) that it can be useful to include a psychotherapist in the planning process. Everyone involved in succession planning needs to be aware of the complex and powerful emotions that affect every participant. Senior professionals who have defined themselves through their roles at the firm may struggle to let go. Younger professionals may have difficulty tempering enthusiasm and eagerness with realism about the pace at which their mentors can embrace this change. And everyone will need to understand the art of compromise.

Creative Succession Planning

Firms have a range of options in creating succession plans. One set of solutions involves creating a "senior professional" status, and endowing that with enough favorable attributes to make it appealing to the senior owners.

Another option is to create a formalized "buy-in" program by which the directors of the firm offer selected mid-level professionals the opportunity to buy equity in the firm as part of the annual review process.

In all cases, counsel and management should analyze the terms of the firm's existing organizational documents (Articles of Incorporation, Bylaws, Shareholders "Buy-Sell" Agreements, etc.) to determine what changes must be made to create the succession incentives.

Conclusion

Ownership planning, not unlike designing a complex structure, calls for awareness of many variables, of both law and business. Growing and mentoring a new crop of professionals so that they are ready and able to become equity owners, while maintaining harmony with existing owners as they await their eventual retirement and buy-out, calls for constant and careful attention. But the results of careful planning are clearly worth the effort: insuring that the success of the firm benefits existing owners and their future successors.▪

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