



Twenty Ownership Transition Pitfalls *The most common mistakes made in transition planning*

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1. Where the ownership of the firm is in more than one person, there is no buy/sell agreement dealing with death or disability. In such events, ownership will pass to the estate of the owner. As a result, the estate has lost leverage to negotiate a sale.
2. Key employees are not allowed to become owners until they are in their forties. Talent may not be bonded to the firm and may leave for firms where they can obtain an ownership position.
3. Ownership interests are distributed as compensation perks rather than to encourage key players to participate in management.
4. Planning occurs too close to the retirement of the principals who manage the firm. As a result, there is not enough time to train successors.
5. Tax advantaged retirement plans (such as pension and profit sharing plans) are not considered as a funding source for an eventual buy-out under a buy/sell agreement.
6. Firms create obligations to retiring partners without providing adequate funding. As a result, retirements of one or more owners may create a financial crisis for the firm.
7. Firms fail to recognize the potential of existing employees to transition into management and business development. As a result, the firm eventually is dissolved or sold for a fraction of value during its prime.
8. Ownership doesn't change except for the death, disability, or retirement of existing owners. There is no plan for gradual admission of new owners prior to that date. In turn, new owners may not have the management skills to continue the firm.
9. Owners make the first step in ownership transition planning using outside appraisers to determine firm value. As a result, the owners find that they have no buyers at those values.
10. Firms fail to consider the value of covenants not to compete to prevent the loss of existing clients upon the departure of employee-owners.
11. Firms fail to consider the option of recapitalization with a limited liability company as a method to make a transition plan more affordable.
12. Future owners are excluded from the ownership transition planning process. As a result, owners are disappointed when employees choose not to purchase ownership interests.
13. Firms fail to fund buy/sell agreements to purchase stock upon disability with disability buy-out insurance.
14. There is a failure to consider ownership transition as merely a part of a strategic planning process.
15. Firms fail to understand that clients like to see younger generations of management being prepared in order to give them uninterrupted service.
16. Firms use attorneys and consultants who are primarily involved in serving asset based companies. These advisors may not understand the special needs of professional service firms.
17. Firms that look to outside purchasers to remedy the lack of an ownership transition plan don't understand the problems that can be created by claims-made professional liability. As a result, former owners may have to buy "tail" insurance or be responsible for deductibles for claims caused by the merged firm.
18. Firm owners often believe that their "sweat equity" should be reflected in the value of the firm. Usually there is no basis for such an assertion.
19. Ownership interests are given to employees without requiring payment. This usually causes unexpected taxable income to the employee based on the value of the interest.
20. Ownership transition planning is delayed because owners don't want to allow employees to be able to look at financial records.

About the Author

Paul M. Lurie has been business and legal counsel for United States and international development and design firms for more than 35 years. He has worked on project planning, contracting, and dispute avoidance and resolution. His unique counseling perspective is based upon his representation of all types of participants in the construction process, including institutional owners, developers, architects, engineers, and contractors. His knowledge of the dynamics of design and construction firms has made him a valuable advisor on issues of ownership structure, transition, mergers and acquisitions.

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