Succession Success: 5 Pitfalls to Avoid

Transferring the family farm from one generation to the next is a complex undertaking. Mixing the demands of business with strong emotional relationships turns succession planning into a minefield for many families. Frequently, initial attempts at discussing succession planning end with hurt feelings and bitter disagreements. Family members end up discouraged and put off raising the topic because they don't want to risk damaging important relationships, hurting others' feelings, or enduring angry exchanges or recriminations.

Procrastination, though, is the enemy of planning success. Issues that are not addressed fester and become more difficult to resolve. Moreover, life does not stand still and every passing year presents new challenges. We've outlined 5 Pitfalls farm families are susceptible to. Addressing these areas of concern in your management and transfer plans will put you far along the path to Succession Success. Neglecting them contributes to misunderstandings, disagreements, and in the worst case, break-up of the family farming operation.

1. Assuming Family Bonds Ensure Good Work Relationships

Acceptance in a family is unconditional. Acceptance in a business is not. Business success is dependent on factors other than love. Successful operations are dependent on business acumen, crop selection, financial management, technical ability, and other skills. What skills does each participant in your operation bring to the table and is there agreement regarding the directions the business is headed?

- Do the current owners want the business to continue as an intact operation?
- Is there a clear vision for the future? Do the current and next generation share the same business goals? Have the goals been discussed?
- What are the leadership and management skills necessary to sustain the business and achieve agreed upon goals? Who possesses these skills?
- If the successor does not currently possess the necessary management skills, will a plan for acquisition of those skills be part of a transfer agreement?

- What are the business' labor requirements? How will they be met?
- What is the expectation for transfer of ownership and change? Is there a transition plan? Has it been accepted by all individuals participating in the business?
- Will the transition be gradual, involving a period of co-management and progressive ownership, or will the transfer occur as the result of a single event, such as a purchase or death?
- Has the transition plan been discussed with family members who are not participating in the business?

2. Believing a Business Can Support Any and All Family Members Who Want to Work in It

Many family members may want to be involved in the farming operation. However, there are limits to how thin farm resources can be stretched or divided. Although money conversations are among the most difficult to have, neglecting this conversation and accepting all comers may adversely effect everyone's livelihood. All participants in the business need to earn a living, and whether that is possible or not is dictated by the numbers. Most data indicates it costs over $50,000 to support a family of four. Address money issues up front. Before accepting additional members into the operation, frankly discuss the impact upon business resources. No matter how much we care about someone, greenbacks aren't a cash crop. If the business resources are stretched too thin, everyone's ability to support their families will suffer.

- Has the senior generation secured their financial future? Is their retirement dependent on a stream of income from farming operations? Sale of land or other assets?
- Is the business strong? What are the prospects for future growth? What are the risks of increased costs of inputs, depressed markets, or livestock illness?
- Do you know important financial information such as the cost of production per enterprise, overall operating costs and cash flow requirements?
- Is there debt? How will it be allocated? Is the operation organized as a corporation or other business entity that limits financial exposure to the business operation or are the owners personally responsible for debts and other liabilities?
- Does bringing another person into the business serve business goals? Will it result in insufficient resources to reinvest in the business?
- If you are seeking employment in the farming operation, consider the following:
  - What skills or qualities do you bring to the business? What are the anticipated benefits to the business that will be attributed to the time and talent you contribute?
  - Does the business truly need what you have to contribute?
  - What does employing you cost the business?

3. Treating a Conversation as a Contract

What does it really mean when a parent says, "Someday, Son, this will all be yours" or "Everything's taken care of." When a daughter says "Sure, Mom and Dad, I'd love to take over the farm," has she made a commitment to purchase the operation? General statements like these leave open lots of room for conflicting interpretations. Even detailed discussions are only a beginning point—not an end. Memories fade and the details of conversations are lost over time, the details aren't communicated to all relevant people, or there never was mutual understanding—each person at the table had a different take on what was actually agreed to. There may have been several dinner conversations about farm management or succession plans, each involving different options or scenarios. How do you determine what precisely was agreed upon and what was only up for discussion?

A major problem with oral agreements, is that everyone tends to remember them differently. Therefore, they frequently result in confusion, disagreements, and even litigation.

Writing down the details enables issues to be clarified and business participants to have a clear understanding of their responsibilities as well as their rights. Relying on oral agreements poses risk. The relevant question is: "How much risk are you willing to take?"

Types of agreements that should be written include:

- Buy-Sell Agreements and Detailed Payment Terms
- Joint Operating Agreements
- Funding Plans
- Rights of First Refusal
- Management and Transition Plans or Operating Agreements
- Estate Planning Documents, such as Wills, Trusts, Financial & Health Care Powers of Attorney
- Job Descriptions & Compensation Packages
- Capital Contributions
- Apportionment of Assets and Profits
- Distribution of Family Heirlooms

4. Ignoring In-Laws, Off Farm Children, And Children of Actively Farming Adults

Each family must assess who should appropriately be included in the succession planning process, at what point they should be included, and to what degree. Many families choose to involve active farming participants to a greater degree than those who are not actively farming. Generally, those participating in the operation have a strong incentive to reach a workable agreement. If others will participate, carefully consider whether they will make a positive contribution. Do they approach challenges with creative ideas and solutions? Beware of including "spoilers" - those who shoot down every idea, will never accept any solution regardless of its terms, and those who are always looking for a fight. In addition, consider those whose cooperation is necessary to the success of your plan. For example, your son may be the only one who is working in the operation, but if his wife is continually unhappy about her husband's working hours, compensation plan, or lack of vacation time, both their marriage and the business goals will be affected.

Consider how the following will impact your business goals and personal relationships.

- How are assets titled? Will a divorce divide ownership of land and other assets such that the business may not be able to continue?
- If there are unmarried participants, will management and transfer plans need to be adjusted upon marriage? What if the new spouse does not enjoy the farming life?
- Are arrangements in place to buy out someone who decides to leave the operation?
- Do spouses—either of the older or younger generation—play a role in the business or in the ability of the business to be conducted successfully? Consider the following:
    - Who provides childcare when business demands are high such as during planting or harvest?
    - Do spouses provide farm labor?
    - Do they have a role in decision-making?
    - What are spouses' expectations regarding their partners' working hours and time off? What about vacations and holidays?
    - What are spouses' expectations regarding retirement?
- What are the expectations of off-farm children?
    - Are they expecting an equal division of assets upon the older generation's death?
    - Is an equal division of assets a fair division? Have some children made greater contributions to the success of the business or provided assistance to aging parents?
    - Is there a child, brother, sister, or other relative who doesn't want to rock the boat now but who is likely to challenge estate or transfer plans in court after the older generation passes away?
- As children of actively farming adults grow older, will they be given jobs in the farming operation?
    - Will all children be offered positions? If not, who will determine who is offered a position and who is not? Who will determine job responsibilities and provide supervision?
    - How many workers can the operation support?
    - Will all children be treated the same or will consideration be given to those who have worked longer or have greater responsibility? Who will supervise their work?

- Will older children always have the best jobs and most responsibility?
- Are children merely hired labor or are they to be trained to take on increasing responsibility?
- Will there be a procedure to terminate a child who isn't fulfilling his or her responsibilities?

5. Neglecting to Execute and Maintain Legally Enforceable Estate Plans, Management Transfer Plans, or Business Organization Structures.

To ensure your goals are achieved and your plans carried out, you must follow the necessary legal requirements.

If you've chosen your business structure in order to limit your personal liability, failure to follow the necessary requirements can defeat the corporate structure and expose you and your family to catastrophic losses. If you've discussed your estate plan with your lawyer but never quite got around to signing the final documents, your plan won't be implemented. Moreover, if you die without a valid estate plan, the government may step in and apply its own rules to determine who inherits your assets and what amount they receive.

- Are documents signed? Are they properly witnessed? Do they comply with changes in the law?
- Have you maintained the requirements of your business organization structure? Have board meeting been held? Have minutes been kept? Have funds been commingled?
- Does your estate plan reflect current circumstances? Have there been births, deaths, divorces, or marriages that you need to take into consideration? Have you purchased or sold property?
- Are assets properly titled so they will pass as you intend them to? Are they titled in your name only or jointly with someone else? If jointly titled, is title held "with right of survivorship" or as "tenants in common"?
- If farming and non-farming heirs have obligations to one another, have documents been formally executed so the agreement is binding? If there is only a "handshake agreement," who bears the risk if someone fails to follow through?

Communication is an important component of the planning process. We encourage you to think about these 5 Pitfalls and discuss them with the important people in your life. If you and your family are finding it difficult to begin these conversations or complete them, consider involving a qualified professional who can facilitate conversation, minimize disputes, and help everyone remain focused on moving forward rather than becoming derailed by the past. The planning process can not only strengthen your business, it can also bring families closer together.

At the **Fraleigh Law Firm, pllc**, our mission is to provide legal services tailored to meet our clients' unique needs. Legal planning enables our clients to look to the future with peace of mind knowing they have taken the appropriate steps to protect themselves, their loved ones, their assets and the quality of their lives.

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