

A STORY OF A HEALTHY FARM BUSINESS SUCCESSION PLAN
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Abstract

Transition Point Business Advisors presents this paper for the purpose of presenting at the upcoming 20th International Farm Management Congress on July 12 to 17, 2015 in Quebec, Canada. The purpose of this non-peer review paper is to illustrate how Transition Point Business Advisors worked through a specific process of Business Succession Planning collaboratively with a client and other key professionals for the benefit of the client. The transition process helps family owned farming operations to have a clear and concise understanding of what is going to happen in the next chapter for the farm as well as the families affected by it. There are many variables, both soft human issues, as well as technical business issues, that need to be reviewed, addressed, and planned for the improved outlook of all parties involved because “tomorrow is coming” whether we are prepared for it or not. In the following non-peer review paper, we walk through a case study describing a successful Business Succession Planning Process as it was applied while working with the owners of a large grain production operation in central Kentucky with their permission.

Keywords:

Farm Succession

Succession Planning

Generation to Generation Planning

Family Legacy

Transition Point Business Advisors

Non-Peer Review Paper

As we have worked with many farm families across North America interested in creating an appropriate Farm Business Succession Plan providing for an orderly and efficient transfer of both farm assets and farm management to future generations, we have found common obstacles including the following:

1. A misunderstanding of the difference between Succession Planning and Estate Planning.
Estate Planning focuses on moving assets from one generation to the next.
Succession Planning focuses on transferring family values and business management and leadership skills to the next generation.
2. A lack of understanding and agreement among all parties as to the desired future vision for the farming operation.

3. A lack of desire to dedicate both the time and the money to create and implement a sustainable transfer of leadership and wealth to the next generation.
4. Starting the Succession Planning process in the wrong place, by focusing solely on moving assets at the time of one's death to the next generation.
5. Or, what we think is the worst timing is not get starting at all. Most of the time they do not know how to begin, where to begin or with whom to discuss this process

Occasionally, we have had the privilege of working with a farm family for whom these obstacles were easily overcome. One such family is one who owns a large grain farming operation in central Kentucky. One of the partners in the operation has previously presented his white paper to IFMA on the successful evolution of a small dairy operation into a large grain producing machine spanning several counties. This white paper will describe the process our firm employed to assist that family in creating a sustainable Succession Plan, which was executed by them in record time, with grace and harmony.

Our relationship with this particular farm family began with an introduction by an agricultural consultant who had been providing profitability advice to this particular farming operation, as well as to a large segment of the U.S. grain industry. In 2012, the ag consultant was making his annual visit to the three partners of the farm who are all brothers. The partners asked the consultant if he could offer them some help in developing a Succession Plan for their operation which would begin to integrate the next generation of the family into both ownership and management of the operation. The consultant indicated that Succession Planning was certainly important for the future sustainability and profitability of their farming operation, but that was not his particular expertise. However, rather than pass on the opportunity to help this family, the consultant offered to introduce our firm, Transition Point Business Advisors by giving our contact information to the three partners. One day one of the partners, the youngest brother, called to learn more about our expertise and our succession planning process. We agreed to schedule a teleconference via Skype in February 2012 with him and his two brothers and his nephew in which they could learn more about our firm and we could learn more about them without either of us leaving office or home. Our conversation lasted 90-minutes. We learned that the three brothers had been considering the need to develop a Succession Plan for

some time ever since the oldest brother's son came back to the farm a number of years earlier as an employee after first enjoying a successful career with John Deere as an engineer. The three brothers had promised their son/nephew an equity stake in the farming operation, but had not yet "got around" to taking action on making good on their promise to him. Like many energetic young people who come back to the farm, the son had been patient. But he owed to his own young family to gain clarity on what his future held if he stayed on the farm. The three brothers knew they wanted to provide the son with an equity stake in the operation somehow, but up to this point the three brothers had been operating as three independent farmers who shared equipment, land and labor. This organizational structure (or lack thereof) was not ideal for integrating another equity owner.

By taking the information we gleaned from our Skype meeting introduction, our firm was prepared to present a written proposal to them, outlining the process we would use to help them create and implement a unique Succession Plan, which would integrate the son into an equity position in a fair and equitable manner. Three weeks later two of our professional associates boarded a plane in Des Moines, IA and flew to Louisville, KY, the airport nearest to the farm. Upon arriving in Louisville we rented a car and drove 65 miles south to the farm. Our firm's policy is to present any business proposal in person so that the potential client has the opportunity to meet us face to face before making a decision as to whether or not to engage our firm.

Our Business Succession proposal contained an outline of our three-phase proven process for engagement:

Phase I: The Diagnostic phase

Phase II: The Plan Design and Implementation phase

Phase III: The Sustainability phase

The proposal provided a fee quote for conducting Phase I of the process. The fee for Phase II would be quoted after the completion of Phase I, to be followed with a quote for Phase III after Phase II is completed.

A week later we received a call from the youngest brother that our proposal had been accepted and they were ready to begin the process. After passing our Engagement Agreement back and forth in the mail for signatures we set the dates for our next trip to Kentucky to begin the first steps of their Business Succession Planning process.

On our next visit to the farm, we spent two days interviewing each of the three brothers and their spouses individually to learn confidentially what each one envisioned for their personal future, as well as the future of farm. We also interviewed the son and his wife as representing the next generation on the farm, along with each of the other Generation 2 children of the three brothers (six in total). In that process we learned that, while some other G2's had a mild interest in being part of the farm in some way in the future, none of them were interested in making a career change at this point. We also interviewed a number of key employees on the farm to learn more about their aspirations and where they might fit in the future.

During our individual interviews we instructed each one on the mechanics involved of having them each complete an on-line personal profile analysis, the results of which would help us to understand the personal characteristics pertinent to each person, both those involved in the operation, as well as those who were not involved.

Before we left to return to Des Moines we picked up a number of legal documents pertaining to farm ownership, along with recent financials for the operation. In this particular case, we found it important for both clients and consultants to gain clarity surrounding each partner's personal financial and estate planning situation.

The next step in our process for **Phase I** was to take all of the interview data we had obtained from the three brothers, along with the financial and legal documents and personal profile survey results back to our office for review and a thorough analysis.

About thirty days later we returned to meet with the three brothers and the nephew/son to present our Diagnostic Report. In the report, we expressed various themes which became prevalent from

the individual interviews so the entire family could gain an understanding of the various themes we discovered without betraying confidentiality.

The report also presented the results of each person's personality style survey, which were shared in detail with the group of partners and their spouses. This action provided confirmation of and greater understanding and appreciation for each person's communication style.

Our Phase I Report also identified current and potential gaps between the partners' vision for the future and the present situation, both from a people perspective as well as from a legal and financial perspective.

Finally, the Phase I Report provided potential solutions and various strategies to be considered in order to close the gaps that had been exposed. No decision as to actions to be taken are expected at this point in the process, but at least all parties were on the same page regarding the issues to be resolved and the potential strategies to be explored further in Phase II.

At this meeting we came prepared with a proposal for Phase II of the process, including fee estimates. It did not take the Petersons long to determine that they all wished to proceed with Phase II as soon as possible.

Before returning to Des Moines, we confirmed an appointment with the brothers' attorney, who also did their tax return preparation. With the brothers' permission we shared the Phase I Report with their attorney. He was pleased with the results of the Report and was gratified that the brothers were taking the steps to develop and implement their Succession Plan and integrate it with their personal financial and estate plans. We shared with him our initial thoughts on potential strategies for closing the gaps and he was impressed, if not a little shocked, at the scope of our suggestions. We invited him to become part of our Collaborative Team of Advisors who would be synergizing on the development of specific strategies as part of our **Phase II Plan Design**.

Two days after returning to Des Moines I received a phone call from the brothers' attorney. He had been thinking about the scope and size of this project and had come to the determination that his small firm was not equipped with the horsepower required to provide the research and implementation of the various strategies which needed to be explored for the brothers. I thanked him for his honesty and invited him to remain on our Collaborative Team as a historical resource. We then sought out additional professionals to be added to the Team for the Plan Design project that was facing us. We went to work searching for both a well-qualified and credentialed estate/business attorney, and a CPA firm which specializes in large farming operations. After a week of research we presented the brothers with a list of three Kentucky law firms who each had a credentialed estate specialist on staff. One of the brothers interviewed each of the law firms and came to a conclusion as to which one they felt could be meet their needs from both an expertise standpoint and from a personality standpoint. We also began a search for an ag-oriented accounting firm. We had worked previously with a specialty firm in another state who was willing to work with this family in Kentucky due to their size and complexity. It turned out that this particular accounting firm used the same specialized accounting software that was being used by the brothers for the last couple of years, which confirmed a good fit.

Our next step in **Phase II** was to go to work with the Collaborative Team we had built to develop and test specific strategy recommendations to bring to the brothers as a unified team to avoid ambiguity and confusion for the client, which so often occurs when individual professionals do their specialty work in "silos" without the benefit of communication between the professionals. We conducted our Collaborative Team strategy work sessions via Go-To-Meeting web video teleconferencing with all of our team members, but without the brothers being present. We have found most clients simply want the answers they are looking for and are not interested in seeing "how the sausage is made". The Collaborative Team came to a consensus regarding the types of legal entities to be created which would both facilitate the integration of the oldest brother's son into the operation now, as well as provide ease for transitioning more owners in and out of the organization in the years to come.

The three entities to be created were:

1. **A Limited Liability Company (LLC)** to own the land currently owned by the three brothers individually. This would allow for an Operating Agreement to govern how future partners in the land ownership could exit without losing family control of the land needed for the grain operation. It was determined that future owners of the LLC would be blood relatives only, but they need not be active in the farming operation. This would allow non-farm heirs to inherit shares of the LLC from their deceased parents in order to continue to be part of the farm, but the Managing Member of the LLC would be required to be active in the farming operation and thus control the negotiation of leases, etc.
2. **A General Partnership (GP)** would own and operate the grain operation itself. The only assets of this GP would be grain inventories and cash from operations. This GP would lease all of the land held by the land LLC. The “partners” of this GP would be the three brothers plus the son, along with their wives for a total of 8 partners. Each partner would first form a single member Limited Liability Limited Partnership (LLLP) to represent their partnership interest in the GP and yet shield each partner from the personal liability of the other partners inherent in a General Partnership. This arrangement still qualified for eight beneficiaries of potential U.S. Government payment programs, which would not be allowed for shareholders of a corporation or LLC.
3. **An S-Corporation** would be established to own all of the machinery and grain handling equipment. This corporation would lease its asset to the operating General Partnership, but would further limit any liability out of claims arising from the use of the equipment, especially the several grain trucks operated primarily by 19-22 year-old employees on the curvy Kentucky back roads. A huge liability risk.

A plan was then outlined to integrate the son into the Operating General Partnership and the Equipment S-Corp as a 25% owner of each of these entities, structured in such a way as to be tax effective for the son as well as the other three partners. The son’s only interest in the land LLC

would be equal to his proportionate share of land the he contributed to the land LLC, and thus would not be a 25% ownership position.

A Buy/Sell Agreement was established for each of the three new entities to make it clear what would happen when an owner/partner exits that entity due to death, disability or retirement. The provisions of each Buy/Sell Agreement would vary according to which entity it was governed by.

A special LLC was then formed to own life insurance on each of the four partners so as to supply the liquidity needed in the event of the death of a partner to purchase that partner's share of the GP and S-Corp from his estate using tax-free funds supplied by the life insurance death benefits. Life insurance would not be used to purchase shares of the land LLC owned by the deceased member, since those shares are designed to be held by the heirs of the deceased for generations to come.

These legal entities were then coordinated with each partner's personal financial and estate plan, individually designed by their personal Certified Financial Planning Practitioner in conjunction with the advice of the Collaborative Team of Advisors. As a result, each partner and their spouse now knows exactly what will happen in the event of that partner's death, disability or retirement.

A year later we entered **Phase III** of the process, which is designed to provide Sustainability of the structures and plans that have been put in place in order for the Succession Plan to succeed. The main focus of Phase III is to conduct an all-day Annual Business Review meeting. This meeting is attended each year by the four principals and their spouses if they are available to attend. In this case their spouses have willingly attended and report that they are feeling much more secure in their understanding of how the Succession Plan for their farm is set up to protect them and their respective families, providing more certainty as to how retirement, death or disability of any one of the principles would affect them individually.

Also, in attendance at the Annual Business Review are members of the Collaborative Team of Advisors, which include representatives from the accounting firm, the law firm and the Certified Financial Planner firm, and the CFO for the farm. Some years a representative of the bank may also be in attendance.

The Agenda for the Annual Business Review includes a review of any decisions that were implemented since last year's meeting and a report on any Action Items which may have been assigned in the last year. Then a report is provided for everyone as to the financial condition of each of the legal entities, along with a consolidated financial report showing the results of the last year. This is followed by a review of the highlights of the legal formation documents for each entity, such as By Laws, Operating Agreements, Buy/Sell Agreements, etc. The law firm then circulates a compliance document for each entity showing that all of the proper filing requirements have been met. If a new partner has joined the business in the past year, then additional documents are signed to solidify the addition of the new partner to the organization.

Time is allotted during the Annual Business Review to discuss any strategic issues that need to be addressed by the owners, such as major building plans, land acquisition or sale proposals are reviewed. The discussion surrounding these strategic issues is conducted in the presence of all the spouses and the Collaborative Advisory Team members, which allows for transparency and full disclosure so as to keep all interested parties informed and in the loop. Additionally, any new issues can be raised at this meeting by any member to be addressed now or in the future.

The meeting adjourns by 5:30 p.m. followed by the whole group gathering at a nearby restaurant for the Annual Celebration Dinner attended by the partners and their spouses, along with the Collaborative Advisory Team members. This Celebration is a welcome capstone to another successful year for the farm, and helps them to kick off a new year of planting, production, harvesting and problem solving by a very progressive group of professional operators, their spouses and advisors.

The Business Succession Planning process can be a marathon for many of our clients. When we celebrate together with them each year it is great to know that our clients are satisfied with their

progress and their goals are being accomplished. We are gratified to play a collaborative part in watching the Plan come to fruition, and to see a flourishing farm operation grow through the efforts of such thoughtful people who really care about maintaining family harmony for generations to come, which is the ultimate end goal when it's all been said and done.

The family was pleased to report to us at this year's Annual Business Review meeting that the oldest brother's youngest son had also just returned to the farm after having a successful career as a mining engineer for the past several years. He can now see a clear career path being laid for him as he joins his older brother and his uncles in continuing to grow and develop their farming operation. Planning pays off!

It is my hope that this paper will encourage other farm families to stop just talking about the need to begin Succession Planning and to actually start the process by first locating a qualified Business Succession Planning consultant who can drive the complete process forward with the help of the family's other professional advisors to reach a successful completion which will benefit their children and grandchildren.