

# Review policies with your lawyer on a regular basis

BY SAMUEL NAGLER

**T**HE MOST CRITICAL but often overlooked policies for large family businesses tend to fall into two categories: transitions and day-to-day business operations.

Leadership and other transition issues may be frequently discussed, and sometimes put into writing, but without the proper structures you could find your policies falling short at the worst possible time—in the midst of an unexpected change. In addition, sometimes informal practices around day-to-day operations become entrenched. Failing to discuss these practices with counsel can leave you vulnerable.

In the course of attending to such “mundane” matters as keeping the business afloat and making a profit, owners and senior leaders may not focus on issues we lawyers tend to worry about. Reminding yourself now to revisit these policies could save you costly legal bills later on.

## 1. Don't wait for a transition before checking your plan.

Whether your organizational documents have served you well historically or you haven't looked at them in years because no problems have come up, a failure to examine transition policies can leave you vulnerable when change takes place.

- **Retiring leaders:** Consider the scenario in which the founder is contemplating retiring or limiting his or her involvement. The operative documents may have given the founder broad authority to make decisions on behalf of the business, or this may have



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been the practice regardless of formal policy.

If the next generation is to succeed the founder, more fine-tuning of the control mechanisms may be necessary. Which decisions can the new leaders of the company implement unilaterally, and which require approval of the governing body? Contracts over a specific amount? Change in product lines? Hiring and firing of key personnel? Budget approval? Instituting or settling litigation?

If other family members do not feel comfortable with the new leader having the same degree of power the founder had, those controls must be addressed in the governing documents. Revisiting operative documents regularly instead of waiting for transitions to hit can help you address family members' concerns and avoid tying the new leader's hands.

- **Divorcing owners:** Your operating/shareholder agreement should already contemplate owner or shareholder divorce, but periodic review with counsel can flush out any vulnerabilities.

For example, many agreements restrict transfers of ownership interests in general but create exceptions for transfers to spouses. A well-drafted agreement gives the company and the other owners the right to purchase shares from a spouse who is obtaining those shares through a divorce decree. Your documents should also ensure that the spouse obtaining shares through a divorce cannot freely convey those shares to a new spouse upon remarriage.

- **Death of a leader:** Don't wait until an owner is dying (or passes suddenly) to review the other owners' rights or obligations with regard to purchasing shares. Typically the operative documents set forth specific timelines for exercising such rights, but it behooves you to prepare in calmer times.

- **Special S corporation concerns:** Upon the death of a shareholder, S corporations can face another pitfall that can put at risk their S corporation status.

For estate planning purposes, shareholders often convey their shares to a grantor trust. In the event of the shareholder's death, that trust loses its grantor status. This requires the trust to make a specific election with the IRS to remain an eligible S corporation shareholder and preserve the company's S corporation status.

It is important to note the election deadline and obtain confirmation that the election has been made in a timely manner.

## 2. Stay years ahead of a potential sale.

- **Audited financials:** If your company produces only reviewed or compiled financial statements, it's usually advisable to switch to audited statements three years before the business is sold.

Though no one looks forward to audit time, and it is a more expensive option, the benefits of increas-

ing a potential buyer's confidence and getting ahead of potential issues generally provide ample payoff.

- **Key non-family employees:** While a sale generally will not be disclosed to employees until the closing is imminent, the buyer may require the services of certain non-family employees.

Even when these employees have a longstanding relationship of mutual trust with the family, it's prudent to discuss their goals for employment and tolerance for non-competition terms in the event of a sale.

- **A plan for problem solving:** In the early stages of considering a sale, you would be wise to develop a process and timeline to identify, quantify and (if possible) resolve any issues that would be of concern to a buyer. These might include major litigation or environmental liability.

Vigilance can also ensure that changes in tax law won't cause problems or lead to missed opportunities. Confirm that your accountant or attorney is monitoring legal changes that could make a sale more or less advantageous from a tax perspective.

### 3. Establish an attorney consultation policy.

My clients will sometimes send me a contract that they have already signed and that is now causing problems. Those e-mails often include a note of regret: "I know I should have sent it to you to look at before I signed it, but ..."

An attorney consultation policy can articulate cost and subject matter benchmarks for when to involve counsel. This ensures that you find the happy medium between paying your counsel's hourly rate to review a routine vendor agreement and blindly surrendering important legal rights.

- **Watch out for red flags:** Some contract provisions virtually always merit attorney review. These include warranties and representations, ownership of intellectual property, insurance and indemnity clauses, defaults and remedies, jurisdiction for litigation, confidentiality and clauses concerning which document will govern in the event of a conflict.

- **Your terms and conditions can't always help you:** The "governing document" provision can sneak in and wreak havoc. A client recently asked me to review a single provision of a customer's lengthy contract, squeezed in microscopic print onto the back of an innocuous-looking purchase order.

My client and I had carefully crafted terms and conditions for the client's company. However, the customer's contract established that it controlled in the event of conflict between its terms and any terms and conditions established by its vendor (my client). We ultimately leveled the playing field—after extensive negotiation.

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### 4. Review insurance annually.

Unfortunately, doing business today subjects a company to more legal risk than ever, enhancing the importance of insurance that truly protects you and your business.

- **The right agent:** Your insurance agent should be a true adviser, not just a robot who can pull quotes and place orders. Seek out an insurance agent who specializes in your particular industry and understands your exposures, challenges and products.

Insurance products are constantly changing. Relatively new products like cyber liability have been added and the degree of coverage offered is shifting, as with officers and directors liability insurance. You need an agent who will arm you with information to make decisions based on coverage comparisons, not simply on cost.

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- **Flagging new concerns:** An annual insurance review can also identify issues that arose in the past year. For example, have you increased your presence in another state to the extent that you now must comply with the worker's compensation laws of that state? Or has a promotion rendered insufficient the amount of key person insurance being carried on an employee?

### 5. Implement, maintain and monitor a data security plan.

A business rooted in a family culture, regardless of its size or sophistication, may operate informally in certain respects. Given the close nature of family relationships at the company's most senior levels, sometimes informality can permeate the company culture.

These quirks in culture are often harmless, but they can create significant liability when it comes to privacy. Data security breaches can have enormous repercussions in terms of cost, time and reputation—but smart policies can help mitigate that risk.

- **What data must be secured?** In Massachusetts, where I practice, "personal information" is defined as a person's name plus any one of the following: Social Security number; driver's license; or financial account or credit or debit card number. State law requires any company holding such information to maintain a written plan for its safeguarding.

Furthermore, if a Massachusetts-based business contracts with service providers outside the state, the Massachusetts data security law mandates that its contracts with those providers require the providers to comply with our state law.

Most states currently have some form of data security law in place for businesses. Your attorney can ensure that your policies satisfy the legal requirements and help you stay ahead of future regulation and avoid costly problems down the line.

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