



*From individuals to generations™*

## Fautores Family Offices Deliverable

---

### A Sample FOMB Case Study: Mom and Dad's Comprehensive View and Alignment

**Michael L. Chindamo, CFP® Partner**

**7/10/2012**

This sample case study addresses what could be some of the problems experienced by family-owned and owner managed business (FOMB) partners. A FOMB will normally have partner and family issues that overlap. This case study will address some family, family partner and non-family partner issues.

## Sample Case Study: Mom & Dad's Comprehensive View & Alignment

### Initial Consultation

#### **Mom and Dad's Concerns, As Expressed to Fautores:**

1. Business Partner No. 1 is a partner in a substantial family-owned business (FOMB). He is not a family member. He wants to sell.
2. Founder's Son is Business Partner No. 2. He is possibly getting a divorce and has no prenuptial agreement. He and his spouse are alcoholics and substance abusers. Spouse feels that she is entitled to a share of the business. Drugs have been found on business property. These behavior patterns have caused disruptions in the business, causing Business Partner No. 1 to want to sell.
3. Founders, Mom and Dad, founded the business, and they are funding long-term care for one Grandparent. They are not funding a long-term care policy. Grandparent's age 92 precludes her from buying a long-term care policy.
4. Founder's Daughter is not active in the business. She has a sense of entitlement and has demonstrated consistently bad financial decisions. Her parents, Mom and Dad, usually take financial responsibility for her. Although they do believe in family non-shareholder and employee non-shareholder fairness, they have no desire to further agitate and complicate the current shareholders agreements by adding an additional partner, particularly one that would not be an asset to the company.
5. Mom and Dad, who are in their sixties, are taking on the cash flow requirements of others in order to keep the peace.

#### **Fautores Important Notes from Initial Consultation with Mom and Dad:**

- Mom and Dad do not want Business Partner No. 1 to sell. They feel he is much too valuable to the business and the succession planning process.
- Mom and Dad are very unhappy with Business Partner No. 2's behavior during his possible divorce process. Partner No. 2, the Founders' Son, has no prenuptial agreement, against his parents' advice. Son is less important to the business at this time than Business Partner No. 1.
- Mom and Dad would like to stop funding others' problems.
- Daughter has been in a "cash crunch" for years. She believes she is entitled to a share of the business.
- Grandparent, whose long-term care is being funded by Mom and Dad, has a substantial amount of value in an illiquid piece of farm property. Farm could have substantial value and liquidity due to developer interest. Grandparent is now 92 years old and not eligible to own a long-term care policy.
- Dad is the sole heir to the farm property.
- Mom owns a valuable antique collection.

- Mom mentioned that she is an animal lover. Mom and Dad own two horses. In the event of her demise, she would like to be assured that some assets can be put aside for the care of the horses for their remaining life.

### **Mom and Dad's Major Objectives, As Expressed to Fautores:**

- Business evaluation
- Estate & asset protection plan review
- Evaluate farm property
- Legal document review
- Retirement planning
- Succession planning
- Property and Casualty review
- Long-term care for themselves
- Assistance with all records and documents
- Family financial education

### **Fautores Important Notes Regarding Mom and Dad's Major Objectives:**

- Mom and Dad's business has never been professionally evaluated.
- Their estate plan is not in line with business valuation.
- Mom and Dad's Property and Casualty policies have not been evaluated to see if they cover the current state of the business. Homeowner's policies are not updated and carriers have been changed a number of times.
- No professional evaluation or riders for Mom's valuable antique collection. It is substantial.
- Farm is titled under Grandparent's name only. She has a simple will leaving her son as a sole heir. Local realtors say the farm property is worth more than \$10 million.
- Hunters use the property, as do children with recreational vehicles. There have been injuries. There has been no permission granted in most cases. There are no signs, leases, liability waivers, or legal documents concerning others' use of the property. Gates and fences have been broken or vandalized. Property is poorly maintained.
- A former disgruntled employee of the family business is claiming he was harassed and discriminated against, and has filed a law suit. The charges could be frivolous.

## **Fautores Initial Concerns Regarding Mom and Dad's Business**

### **Potential Risks and Concerns**

- Is there an excessive estate tax burden due to an outdated estate plan?
- What is the liability exposure if a catastrophic event happens on the farm property?
- Business Partner No. 2's impending possible divorce could lower the value of the business. Son's assets will be greatly depleted. Drug related criminal activity can negatively affect the business as well as potentially destroy the family.
- The business will become less-desirable if Business Partner No. 1 leaves. Certainly the business will suffer.
- Mom and Dad's two children—Son [Business Partner No. 2] and Daughter—are financially and emotionally unprepared to deal with the untimely death of Mom or Dad.
- Do they have enough life insurance, and how does it need to be owned? Who should the beneficiaries be?
- Investments may need to reflect a different and more conservative approach due to retirement and cash flow concerns. Investment policy statement is not comprehensive and outdated. Their 401K plan has no Investment Policy Statement.
- Daughter's funds are almost depleted. Mom and Dad continue to support her, no matter what.
- What if Mom or Dad pre-decease Grandparent? Their children do not have the skills to negotiate with the developer that has expressed an interest in the property. The company's lawyer is not experienced in this area.
- Are there discriminatory behaviors occurring in the business? If so, they need to immediately be identified. Can assets be protected without committing a fraudulent transfer?

### **ACTION STEPS, AS RECOMMEND BY FAUTORES**

- ✓ Work with Mom, Dad their CPA and attorney to coordinate entire legal document review for business and personal.
- ✓ Get updated professional evaluations on all assets, including the business and Grandparent's farm property.
- ✓ Revise and address estate plan with strong consideration to Grandparent's simple will and farm property due to property's substantial worth.
- ✓ Revise Grandparent's legal documents to protect her assets, and create irrevocable trusts to help shelter and asset protect the value of the farm. Start immediate gifting program.
- ✓ Attain a professional evaluation of the farm and family business as well as a professional appraisal of Mom's valuable antique collection.

- ✓ Re-evaluate all property and casualty coverage and titling for Grandparent's farm, Mom and Dad's personal coverage, and Mom and Dad's business. Add antique rider to Mom and Dad's homeowner's policy. Explore the cost of a new homeowner policy through a highline insurer that can offer comprehensive coverage with an added personal umbrella. Adjust auto coverage and homeowners policies, if required, to meet the minimum for the umbrella. Check to see if insurer has a recommended vendor program in the event of property claims.
- ✓ Place signs, repair fences, and post warnings on farm property. Simultaneously attain upgrade on personal umbrellas of at least 2 - 5 million. Photograph after completion. Have estate attorney strategize the immediate transition of ownership, proper titling with an asset protection strategy to Dad or irrevocable trust as soon as possible. Consider entity planning such as an LLC (Limited Liability Company).
- ✓ Meet with developer to attain a written offer on the property. Design entity and estate plan that coordinates with the offer if acceptable. Strategize the best outcome, tax & estate-wise, while attaining the best asset protection. If dad chooses to partner or self-develop, then an LLC could be in order.
- ✓ Initiate financial education program for Daughter, Son [Business Partner No. 2], and employees. Address Daughter's issue of her entitlement to the family business. Possibly set up an ILIT (irrevocable life insurance trust) for Daughter in the event of Dad's early demise. Have provisions that pay an allowance versus a lump sum.
- ✓ Revise IPS – Create new Comprehensive Investment Policy Statement to reflect what disciplines are now required by Mom and Dad to meet retirement plan projections. Align the risk with outside investments. Include Fiduciary procedures.
- ✓ Asset review – make changes to reflect any immediate cash flow needs. Investments need to be more than suitable. A 321 or 338 level fiduciary review with recommendations of Fautores “best of breed investments and practices” need to apply.
- ✓ Address Son [Business Partner No. 2]'s shares, possible divorce situation and his personal financial plan. Address the prenuptial agreement situation immediately.
- ✓ Encourage Son [Business Partner No. 2] and his spouse to immediately start counseling for marriage and substance abuse. Offer an incentive based on son and his spouse's attitude and progress with input by attending licensed family therapist. Have the attorney check the agreement for language and consequences of executing a termination clause. Check to see if an untreated substance abuse, refusal of treatment or a felonious act is a reason for termination as well as a buy-out provision of the shares. Have son take an Occupational Personality Questionnaire (OPQ 32) and MAXXAttain ScoreCard.
- ✓ Measure the current life insurance policies (Confidential Policy Evaluation – CPE) for financial strength and claims paying ability, cost competitiveness, pricing stability, relative policy value and historical performance.
- ✓ Have Fautores initiate the Comprehensive Family Wealth Roadmap™ Assessment for the family and follow up with an Occupational Personality Questionnaire (OPQ 32) and MAXXAttain

ScoreCard on Business Partner No. 1 to determine true motivating factors and leadership capabilities. Then, based on those results, offer the motivating incentives that will keep that partner from leaving.

- ✓ Have Fautores Human Resource Team coordinate and review all present HR procedures and policies as well as past records. Make sure that all procedures are in compliance with federal law.
- ✓ Have Fautores coordinate with the appropriate law firm the creation of pet trusts to accommodate Mom's wishes to have funds for life-time care for the horses.

The case study is an example of what can happen in real life. The dynamics involve familial issues that are further complicated with family business conflict that can lead to the disintegration of the business and family. The founder is faced with some very difficult issues that require strong leadership skills to resolve. Please note in the case study where the son and daughter-in-law are drug addicted, have committed a felony, contemplating a divorce & there is no pre-nuptial agreement. The daughter-in-law feels she is entitled to the assets including a share of the business.

Ask yourself, who has the leverage now? Does the founder have the strength and mental fortitude to make the decisions necessary to stabilize the business?

*\*Note: The case study is a basic example of what situations can occur when you own a family owned and owner managed business (FOMB). Certainly some of these life events apply outside of business ownership as well. All factors need to be considered and aligned. Without interdependent factor alignment the plan has less of a chance of success.*