



## **AIA Best Practices: Twenty ownership transition planning mistakes**

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Excerpted and adapted from a Design Intelligence article by Paul M. Lurie

### **Summary**

Ownership transition takes time, initiative, planning, and communication to be effective. Ideally the process of leadership change helps to further the growth and success of the company after the founders' tenure. For successful transition planning, avoid these 20 common mistakes.

1. If there are multiple firm owners and there is no buy/sell agreement dealing with death or disability, ownership will pass to the estate of the deceased owner. As a result, the estate has lost leverage to negotiate a sale.
2. Key employees are not allowed to gain ownership until they are in their forties. As a result, talent may not be bonded to the firm and may leave for other firms where the possibility of an ownership position occurs earlier in life.
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, leaving insufficient 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 buyout under a buy/sell agreement.
6. Financial obligations to retiring partners are created without adequate funding, potentially causing a financial crisis for the firm when one or more owners retires.
7. Firms fail to recognize the potential of existing employees to transition into management and business development. As a result, the firm may be dissolved or sold for a fraction of its value during its prime.
8. Ownership doesn't change except for the death, disability, or retirement of existing owners. No plan exists for gradual admission of new owners prior to that date. As a result, new owners may lack the management skills to continue the firm.
9. Owners take the first step in ownership transition planning when they work with outside appraisers to calculate the value of the firm. As a result, owners cannot find buyers at the value they have helped to determine.

10. Firms fail to understand the value of covenants not to compete to prevent the loss of existing clients upon departure of employee-owners.
11. Firms fail to consider the option of recapitalization with a limited liability company to make a transition plan more affordable.
12. Future owners are kept out of the planning for ownership transition. 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 buyout insurance.
14. Ownership transition is not considered a part of a strategic planning process.
15. Firms fail to understand that clients like to see younger generations being prepared for management because it assures the client of uninterrupted service. Older owners must understand that the cemetery is filled with indispensable people.
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. Founding owners often believe that the value of the firm should reflect their "sweat equity." 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 look at financial records.

## About the contributor

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This article corresponds to:

*Architect's Handbook of Professional Practice, 15th edition* Unit 1 - The Profession

Chapter 05 – Organizational Development

Section 06 – Ownership Transitions