

Succession Plans Part Art, Part War

STRATEGY: Family businesses need a formal plan, few have them.

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Staff Contributors

Engineer **Allen V.C. Davis**, 87, invented a steel switch in 1948 that has helped propel the Saturn V, the Apollo missions to the moon, and countless airplanes, helicopters, rockets, tanks and missiles manufactured since then.

The two businesses he founded, Burbank-based **Hydra-Electric** and Chatsworth-based **Custom Control Sensors Inc.** (CCS), grew quickly, with annual sales of \$10 million to \$18 million each, and became critical — and profitable — suppliers of pressure switches to aerospace companies and industrial manufacturers. The profits helped fund foundations that have supported the work of professors at **California Institute of Technology** (Cal-Tech) and other universities for years.

For the last two years, however, the Davis family and the companies have been embroiled in lawsuits that speak to the enormous challenges of succession planning in a family-owned enterprise. They illustrate the misunderstandings that can occur between generations over the course of decades.

Reconciliation may be in the works, according to family representatives. But those familiar with the battle for control of the companies know it has nearly torn this family apart.

Meanwhile, the two family-owned businesses remain in stiff competition with each other for similar clients in the midst of a recession and declining military spending.

A lack of succession planning is still a major problem for family-owned businesses today, even though there has been some improvement over the years.



PHOTO BY DAVID SPRAGUE.

Founder: Allen V.C. Davis became embroiled in legal troubles with family members.

Professional services firm **PricewaterhouseCoopers International** (PwC) surveyed more than 1,600 family-business owners and managers in 35 countries and found that 47 percent of the respondents had no succession plan in place. The data came from the 2010/2011 “Kin in the game: PwC Family Business Survey.”

Professional advisers to family businesses say the trick is not to mistake estate planning with succession planning.

“They’re not the same,” said **Otis Baskin**, a consultant for **The Family Business Consulting Group, Inc.** and a professor at **Pepperdine University’s** Graziadio School of Business and Management. “True succession planning is about continuity planning, both for the business and the family.

That means creating active owners, who not only work in the business but have real knowl-

edge of operations, can read financial statements and have a real voice in decision-making, Baskin said.

Beyond this, it’s critically important to have outsiders on the board of directors who are neither family, nor management. And as decisions shift to the new generation, it’s important to have a governance process with clearly spelled out distinctions about who has authority for what.

Especially in the second generation, “there needs to be clearly written distinctions protecting the owners’ rights and giving clear authority to the managers for making day-to-day operating decisions and the board for supervising management,” Baskin said.

Bringing children onboard as operating executives can also be tricky, experts say.

It’s important to set performance targets for the children who want executive roles, said **Al-**

Please see NEXT page

Succession: Family Businesses Should Plan for Future

Continued from previous page

fred E. Osborne, professor at the **University of California, Los Angeles's** Anderson School of Management and faculty director of the Price Center for Entrepreneurial Studies.

One family's story:

In the case of the Davis family, the engineer's decision to give his children and grandchildren an interest in CCS has resulted in bitter disputes.

In a 2009 lawsuit Davis filed against his daughter Joann Acuff and son-in-law Henry, Davis alleges that the two engaged in "self dealing," "breach of fiduciary duty" and "wrongful transfer of stock of certain companies to themselves."

(Henry Acuff was president of Hydra from 1986 to 2008, and has been president of CCS since 2008. Joann, a certified public accountant, has been a longstanding member of the boards of directors of Hydra and CCS.)

That lawsuit states:

"About three years before January 2009, Davis expressed his intention to bequeath some of his remaining assets to charitable institutions as he had already provided for his children and their spouses.

After Davis expressed those intentions, Joann and Henry Acuff, his daughter and son-in-law, became increasingly rude and disrespectful to him, exercising their majority control of the companies to overrule Davis's business decisions, remove Davis from various controlling positions with companies ... and generally exclude him from control of the companies. Because of the interference by Joann and Henry with his business affairs, Davis hired independent advisors to audit his companies, documents and assets.

As a result of the audit, Davis discovered that

his children and their spouses were engaged in a complex scheme designed to take advantage of his trust and confidence in them by depriving Davis and his late wife of the ownership and control of their assets".

The matter went to arbitration and dealt with whether Davis was entitled to receive royalties and licensing fees on patents dating back to the 1950s. A three-judge panel, which included former California Attorney General **John Van de Kamp**, unanimously ruled on June 10 that those patents had expired by Jan. 5, 2005, and ordered Davis to return \$7.3 million in back royalties. A Superior Court of California, Los Angeles, confirmed the ruling on Sept. 12.

"It gutted that lawsuit," said **Ron Rus**, an Irvine attorney representing CCS and the Acuffs. "What the arbitration made clear was that Davis's claims that his daughter did anything wrong are not true. He was just wrong in his premise that he was entitled to receive extraordinary portions of the profits of CCS forever."

Los Angeles-based attorney, **Hilel Chodos**, who represents Davis, said the arbitration judgment "does not resolve the issue." He declined to comment further on the record.

Rus said there are other outstanding issues between the parties, but he declined to comment citing ongoing confidential negotiations.

"We would be pleased to resolve (issues) with him (Davis) so he can be part of the family again," Rus said.

Importance of succession planning

It's not clear if better succession planning would have helped Davis and his family, and the companies they run, avoid these problems.

Mina Sirkin, a lawyer who specializes in estate planning and probate and trust law, said she notices more family-owned businesses are better documenting their succession planning com-

pared to about 10 to 15 years ago. However, she also notices those plans often falling through the cracks.

"They do the document, but then they don't actually implement what happens in the next five years," said Sirkin, a partner at Woodland Hills-based law firm **Sirkin & Sirkin**, who works with many family-owned businesses. "You have to actually revisit the document, and revisit it every three to five years."

Sirkin said companies should particularly be prepared for unexpected deaths or illnesses of key members in the business. The PwC study showed that 62 percent of the companies did not have plans for how to handle the sickness or death of a key manager or shareholder.

People passing their businesses to children or a younger generation of family members also should make sure they include provisions for major disputes in their written plans, she said.

"People don't think of building an arbitration or mediation clause that enables people to resolve these family issues before things get into court," she said.

Davis and CCS had a 1957 agreement that contained a clause providing for arbitration of "any controversy or claims" related his patents, according to the Superior Court's arbitration judgment. It still didn't keep them out of litigation.

As the family looks to resolve its differences, Hydra-Electric, under Chief Operating Officer **Robert Schacht**, is expanding into new electronic switches, adding a new facility and has hired 60 new employees in recent years. Revenues were \$14 million, down from \$18 million in 2009 and \$16 million in 2008, the company said.

CCS is "experiencing its best sales achievements ever," Rus said.