

The Bonding Bind – Does Your Bonding Company Know Your Succession Plans?

By Matt Donovan

Bonding is critical to the health of many electrical contractors. To the extent contractors engage in jobs requiring bonding, their ability to bid on or perform jobs is limited by their bonding coverage. In setting the capacity limits, bonding companies consider, of course, the company's financial statements and claims history. However, faith in company management is important to the bonding company as well. Therefore, to maintain (not to mention increase) a company's bonding limits, the electrical contractor needs a strong and committed management team as well as strong financials.

Succession planning, through the orderly transfer of ownership and control, seeks to ensure that a company maintains a strong and committed management team, and remains financially strong, across many generations of owners. However, to be successful, succession planning often involves change to a company's management and/or financial structure. If not properly managed, these changes can become areas of concern to the bonding company. For example:

Financial Impact to the Company

If the succession plan involves a sale, will the sales proceeds be funded (directly or indirectly) by the company? If so, how will this "liability" affect the company's balance sheet and cash flow? If the buyout is to be paid from future cash flows (i.e. an

"unfunded" liability), it may hurt the company's financial strength in the eyes of the bonding company. In some cases, the bonding company may require the company to place restrictions on buyout payments in order to protect the company's financial strength.

Management Strength

How will a change at the top affect the bonding company's faith in company management? Although current management may have a long and successful relationship with the bonding company, their successors may not. This may be true even the successors have worked at the company for years. If so, the bonding company may tighten its bonding coverage until such time as the bonding company gets comfortable with the new management team. This, of course, could hinder new business and growth plans.

Personal Guarantees for New Owners

If there is a sale or gift of a minority interest in the company, will the bonding company require the new owner to post a personal guarantee? Typically, bonding companies require all 10 to 15% or-more-owners to post personal guarantees to the bonding company.

Removal of Personal Guarantees for Retiring/Selling Owners

For the outgoing owner, part of the desire to transfer ownership may be to diversify his or her

assets and to minimize investment risk. However, if not familiar with the successor management team, the bonding company may be unwilling to release or limit the outgoing owner's personal guarantees.

Estate and Gift Tax Planning

If an ownership transfer is to a trust or other legal entity for estate planning purposes, the bonding underwriter will need to know this in order to determine whether a personal guarantee is needed in connection with the transfer to the trust and, if so, by whom. While it can make the succession planning process more complex, it is better to consider bonding issues early in the succession planning process. If you do, the bonding company will:

- Better understand the benefits to itself as well as the company of proactive succession planning,
- Have an opportunity to gain confidence and trust in the successor management team before a change in control,
- Better understand the financial impact, if any, to the company associated with funding the ownership transfer, and
- Be more flexible when the time comes to remove or limit the outgoing owner's personal guarantees.

Paying attention to bonding considerations early in the succession planning process will pay dividends to the company and its current and future owners.