

## BUY-SELL AGREEMENTS

**An essential tool for succession planning and managing** ownership rights and obligations, buy-sell agreements are appropriate for most every type of business and business entity.



The primary objective of a buy-sell agreement is to control the transfer of the ownership interests of a privately-held company while providing a market for such interests. They allow owners to establish a method or formula to determine a fair price for ownership interests in advance of predictable or unpredictable events, helping to avoid the possibility of disputes that could result in the liquidation of a business.

Buy-sell agreements are also useful to prevent transfers of ownership interests to unwanted third parties or that could result in unintended tax consequences. Finally, buy-sell agreements are often incorporated into and form an integral part of a business owner's personal estate plan.

Though every buy-sell agreement will be tailored to suit the needs of a business and its owners, the following briefly summarizes some of the more common terms and conditions:

- **Introductory Statements:** These recite the purpose of the buy-sell agreement, define terms used throughout the agreement and contain preliminary statements of fact regarding the business and the parties involved.
- **Transfer Restrictions:** The transfer of an ownership interest will be valid only if permitted by the terms of the buy-sell agreement. Transfers of an owner's interest to his or her own living trust are generally permitted and the buy-sell agreement will apply to the trust as well as to the individual settlor of the trust. Owners can also agree to permit transfers to spouses and/or lineal descendants, often limited to persons who are employed by the company.
- **Right of First Refusal/Third Party Offers:** Should an owner receive a bona fide offer from an outside third party to purchase all or part of his or her interest, the company and the other owners can be given the first right to purchase the interests for the price and upon the terms offered by the third party. In addition, "put" and "call" options can be included in a buy-sell agreement to address instances where all of the ownership interests of a business are sought to be acquired by an offeror.
- **Triggering Events:** Certain "Triggering Events" will compel the sale by an owner of his or her interest, usually first to the company and then to the other owners in proportion to their existing ownership. The purchase price for an interest to be sold upon the occurrence of a Triggering Event is established in advance by formula, appraisal or agreement. Triggering Events commonly include but are not limited to:
  - Death of an owner;
  - Disability of an owner (the inability of an owner to effectively carry on his or her normal duties with the company during a prescribed period of time);
  - Cessation of employment, whether voluntary or involuntary, including retirement, loss of professional license or termination by mutual agreement; and/or,
  - Upon an involuntary transfer of an owner's interest due to bankruptcy, divorce or other matter which can result in an interest being subject to transfer by a court order.

- **Procedural Requirements**: The buy-sell agreement will establish procedures for completing the sale and purchase of an owner's interest.
- **Price**: The price payable for an interest to be sold pursuant to the buy-sell agreement can be determined by appraisal or agreement based on fair market value as determined by the company's accountants. Alternatively, the parties can devise a formula reflective of the business conducted, such as company revenues over a fixed period. If a buy-out is funded by insurance, the minimum price would normally be the greater of the net insurance proceeds and the price established within the buy-sell agreement.
- **Payment Terms**: Once determined, the purchase price can be payable by lump sum or down payment and monthly installments payable over time, together with interest. Purchased interests can be held in escrow until fully paid, allowing the purchaser to exercise all rights of ownership. In the event of a default in payment obligations, the ownership interest (or the unpaid portion thereof) can revert to the seller. Provision can be made to guaranty or to secure payment obligations of a purchaser, including by a lien on the assets of the company.
- **Buy-Sell Trust**: Purchasing and maintaining life insurance on individual owners in a buy-sell trust to fund a purchase of their interests on death can have significant tax advantages. The trust is usually designed to ensure that life insurance proceeds are paid to a deceased owner's family and to avoid the adverse tax consequences that can result from the transfer of a life insurance policy.
- **Non-Competition, etc.**: Buy-sell agreements can provide for covenants by individuals selling their interests not to compete or interfere with a company's business, solicit the company's customers or employees or divulge confidential or proprietary information for a specified period after their interests have been acquired.
- **Miscellaneous**: Included are provisions with respect to the construction and enforceability of the buy-sell agreement, the availability of arbitration for dispute resolution and various other terms and conditions for the benefit of the parties.
- **Representation**: The attorney preparing the agreement often represents only the company and each party has the right and is given the opportunity to consult with legal counsel of their own choice.



The foregoing is merely intended as a summary and, along with exploring these issues in greater detail, our business attorneys will address a number of additional matters to determine what should be included in each buy-sell agreement.

In preparation for a meeting to discuss your buy-sell agreement, you will need to gather all relevant company documents and agreements, such as by-laws, operating or other shareholder agreements as well as any prior buy-sell agreements, stock certificates, stock benefit plans and insurance policies covering key principals.

Your questions help us determine your needs so please feel free to ask us about any matter of concern to you as we make our way through the process of creating your buy-sell agreement.

Please feel free to contact attorney [Joe Wener](#), or any of our capable team of [business law specialists](#), to discuss how a buy-sell agreement might work for you, or for assistance with any other business or succession planning questions.