

## The Buy-Sell Agreement: Asset Protection from Within

Every business plan should include a financially sound, well-documented arrangement to address the continuation of the enterprise in the event of the withdrawal, disability or death of one of the current owners. The primary instrument, commonly known as the “buy-sell agreement,” governs the responses to multiple events and contingencies, including the terms of purchase and sale of the interests of that owner in the company. Specifically, the agreement establishes, in advance of the often crisis-filled trigger event, the obligations of the owners (and those of their estates or trusts) so that the remaining owner may have the certainty of funding the buy-out, and the withdrawing owner may depend upon the preservation of value of his or her interest. Needless to say, if the amount and source of payment, not to mention the details of the trigger events, for the purchase and sale are not negotiated before the need arises, then everyone concerned stands to lose.

The buy-sell agreement, in theory, is a proverbial “no-brainer.” Departing business owners want to ensure that they are compensated fairly for their interest in the entity, and remaining owners wish to avoid the burden of a substantial buyout. As for the dearly departed owners, the estate planning element of this agreement is to provide for the fair and timely purchase from their estate or trust, while surviving owners hope to preserve the continuity of ownership and management, rather than being forced into a business relationship with the successors of the deceased owner. In order to prevent future disputes regarding these critical terms of a buyout, preferences related to the sale and future management of the company may be resolved and reduced to writing by the business owners before they become either a survivor or a decedent. Enter the buy-sell agreement.

A properly drafted buy-sell agreement can achieve each owner’s goals by specifying and providing for the “trigger events,” upon which the departing owner will be guaranteed that his interest in the business will be purchased using a predetermined formula, while the remaining owners are guaranteed that they will have the opportunity to purchase such interest. The most common examples of trigger events are death, disability, retirement, bankruptcy and divorce. The bankruptcy or divorce of an owner could have a crippling effect on the business, and the required sale to the remaining owner avoids the complications of the legal proceedings by “cashing out” the troubled party. A well-drafted agreement will also establish an affordable and workable method of determining the purchase price of the departing owner’s business interest, including a preference for a recognized methodology of valuation

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for the departing owner's interest (often used to reduce estate taxes). These terms may be hollow promises when the payment of the formula price comes due to the heirs of the deceased owner, so most agreements provide for a specific source of funding for the buyout (typically, a requirement to maintain an insurance policy on the life of each owner), which have the added benefit of preventing undue financial burdens on the survivors to the business.

The buy-sell agreement, when thoroughly negotiated and properly funded, can provide assurance to business owners that the loss of a partner will not lead inevitably to the loss of the enterprise. Moreover, these arrangements can provide the liquidity by which the departing owner's family may apply to estate taxes and estate administration expenses which may arise. Once implemented, of course, the agreement can be revised to reflect changing circumstances and goals.

Despite all of the obvious benefits of establishing a buy-sell agreement, many business partners tend to avoid these sometimes thorny or sensitive issues by paying lip service to the concept, deferring the discussion until the next shareholder meeting. Many owners do not broach the subject at all. Sometimes, a partner is uninsurable, making the plans for equitable funding of the buyout more of a challenge. Still, the buy-sell agreement has proven in practice to be well worth the time and effort, since it can provide confidence and security to each of the business owners and their families that both buyer and seller will benefit from the labors of building their enterprise, come what may.

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### TRIGGER EVENTS IN BUY-SELL AGREEMENTS

The mutual obligations in a typical buy-sell agreement are triggered when one of the owners:

- Becomes Incapacitated
- Becomes Legally Separated
- Is Sued for Divorce
- Declares Bankruptcy
- Retires
- Withdraws Involuntarily
- Becomes Dearly Departed

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