Buy-Sell Agreements

Charlotte and Suzy started a business as equal partners ten years ago and worked hard to make it successful. They had gone to college together and were the best of friends. They built their business into the region's biggest widget manufacturer. The business grossed $25 million per year and employed 100 people. Since they were good friends, they did not feel the need to have a buy-sell agreement. Unfortunately, Suzy was involved in an automobile accident that left her paralyzed and unable to work. Her husband, John, decided that he would take her place in the business. John had always thought that Suzy and Charlotte were not "tough enough" and immediately began to cause trouble with the employees, customers and suppliers. The business began to lose sales and had to lay off employees.

What happened to the business as a result of Suzy's accident need not have happened. Had Suzy and Charlotte entered into a buy-sell agreement which addressed this and other matters, the business may have had a better chance to survive without Suzy. This agreement could have prevented john from coming into the business. A buy-sell agreement can provide for the "what-ifs", such as what will happen if one of the owners becomes disabled, dies, divorced, or decides to leave the business?

Buy-sell agreements are generally included within a business' operating, partnership or shareholder agreement depending on the corporate structure of the business.

Purposes. There are many reasons to have a buy-sell agreement for your business, such as:

- Facilitate continuation of the business after the death or disability of one of the owners;

- Provide a method for paying the departing owner or his or her family;

- Establish a mechanism for determining the purchase price and a method for paying it;

- Prevent unwanted transfers of ownership interests to "outsiders", such as spouses or other parties;

- Provide a procedure to resolve disputes among the owners;

- Provide for "tag along" and "drag along" rights;

- Protect the "S" status of a corporation, if appropriate; and

- Provide for a source for the payment to the departing owner or his or her family.

Restrictions on Transfers. Buy-sell agreements generally provide for certain restrictions on the ability of an owner to transfer his or her shares. Such agreements typically give the other owners the right of a first refusal to match the offer presented by a third party or an option to purchase the ownership interest if that interest is subject to being transferred, such as pursuant to a creditor's sale or attachment, bankruptcy, or divorce, or upon the owner's death. These events are often call "transfer events" or "triggering events", and they give the other owners the right to acquire the ownership of the affected owner.

Purchase Price. Since most closely held businesses do not have a readily ascertainable value, the agreement could provide for a formula or other mechanism to determine the purchase price to be paid to a departing owner. For example, a formula could be based on book value, profits or revenues. The owners could agree to hire a qualified appraiser. Some agreements permit the owners to agree as to the value of the business periodically. The agreement could also provide how the purchase price will be paid, such as monthly, quarterly, over a certain period of time. It could also provide for how the payment will be collateralized.

Non-compete; Confidentiality. The agreement could include provisions forbidding the owners from competing with the business while they are owners and for a reasonable time thereafter. Also, the agreement can provide for the protection of the business's confidential information, non-disparagement, non-solicitation of customers and employees, and provide other protections.

Every business should be given the best chance to exceed. A buy-sell agreement can help provide that chance to a business by anticipating the possibilities of an owner's death, disability or other event that causes that owner to no longer be involved in the business, or if a dispute arises between them. There are many other issues to consider in preparing such an agreement. If you have any questions or would like to explore an appropriate agreement for your business, please call us and ask to speak to one of our attorneys.