



Why Buy and Sell Agreements Matter to Business Owners

By Tim Bellon, CBI, CMAP, Owner of VR Business Brokers in Apollo Beach, FL

If you're in business with a partner, you already know that your partnership - like your company - can change over time. If your initial shareholder agreement didn't include Buy and Sell provisions, it's essential to add them.

A Buy and Sell agreement is a legally binding contract that stipulates how a partner's share of a business will be reassigned if that partner dies or otherwise leaves the business. It may also cover what happens if a partner becomes disabled or unable to perform business functions, gets divorced, files for personal bankruptcy, or experiences other significant life events that may impact the partnership.



"Generally, the Buy and Sell agreement prevents the remaining partner(s) from being forced into being in business with family members: surviving children, or a disgruntled ex-spouse," says Kathy Cold, an attorney specializing in corporate law in the Jacksonville office of Lippes Mathias Wexler Friedman. Cold recommends that every partnership begins with an exit strategy in mind. "This year in particular," she says, "has shown us that circumstances, both personal and in business, can change in an instant. It's a really good idea for partners to sit down early to discuss what happens when one of them leaves the business."

In the case of a partner's death, some of the cost of the buyout may be covered by a life insurance policy the company pays for. Any other exit must be part of a negotiated agreement, which is best done well in advance. Cold says, "If the partners are having issues with each other, it may be very difficult to negotiate and to decide how to value the business. This kind of agreement is like a prenup; it's much easier to come to terms at the beginning of the partnership when both partners are eager to come to terms and are optimistic about the partnership."

The Buy/Sell Agreement should have a provision that covers how the business will be valued after events that might trigger a buyout. A formula valuation can be used, or the parties can simply agree on a value, with the idea that it will be revisited each year. However, the agreement should provide that if too much time goes by without an actual redetermination of value, that an appraisal will be made so that the valuation will be fair.

In addition to covering the "Three Ds" (death, disability, and divorce), the Buy and Sell agreement also defines what happens when a partner simply decides to leave the business, including the timeframe the remaining partners have to buy them out. "When you don't have any written contract that covers what happens when one partner wants out, you can run into real problems," says Cold. The exiting partner doesn't have an obligation to sell, and the remaining partner doesn't have to buy them out."

A corporate law attorney is invaluable when you're working out these issues. She'll explain your options and help you understand the implications of the choices you make. An objective third party helps keep emotions out of the negotiations and makes sure the agreement is binding and equitable. Gwen Griggs, a corporate attorney and founder of ADVOS Strategy and Law, says Buy and Sell provisions are a critical part of an overall governing document for an LLC or corporation. "They protect each partner," she says. "Since you don't know in advance



Tim Bellon, CBI, CMAP
Owner of VR Business Brokers
in Apollo Beach, FL
Phone: (813) 260-3127
Email:
tbellon@vrsouthshore.com



Why Buy and Sell Agreements Matter to Business Owners

By Tim Bellon, CBI, CMAP, Owner of VR Business Brokers in Apollo Beach, FL

which partner may leave the company first, or under what circumstances, you'll benefit from a detailed and thoughtful document that covers a wide range of possibilities, including a mechanism to determine how to value each party's interests. Restrictive covenants are another example, designed to prevent problems that may come up when a partner leaves, such as protecting Intellectual Property, starting a competing company, or soliciting away employees, customers, or vendor relationships."

Another important function of the Buy and Sell agreement is to define what happens when the majority partner(s) want to sell. "You'll need to be clear about what the implications are for the minority partner(s)," she says. So-called "Drag Along" rights require the minority partners to sell their shares when the majority decides to sell, so buyers can have complete control of the company. ("Tag Along" rights give minority shareholders the option, but not the obligation, to sell.) Griggs says you'll also want to define what happens when a partner or employee with shares is fired. Depending on the position, the employment agreement may require the employee to sell the shares back to the company.

If you think things can get complicated between business partners, imagine the same scenario within a family-owned company, many of which tend to operate without formal agreements. "This is where the Buy and Sell agreement becomes essential," says Cold. "You may have some family members who are working in the business, and others who aren't, but stand to inherit or expect to influence decisions. You may have siblings with equal roles and no clear senior partner to make decisions. Without a good contract and good advice, things can fall apart quickly."

Drafting a detailed Buy and Sell agreement within your original shareholder's agreement may take time, but it's time well spent. Gwen Griggs says, "Partnerships are very much like marriages; clarity and certainty make them both stronger."



Tim Bellon, CBI, CMAP
Owner of VR Business Brokers
in Apollo Beach, FL
Phone: (813) 260-3127
Email:
tbellon@vrsouthshore.com