Are You Prepared for the Future?
The Importance of Buy-Sell Agreements

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I am sure you are familiar with the famous quote by Mark Twain, "Never put off until tomorrow what you can do the day after tomorrow". I know what you are thinking – that this does not apply to you because you are NOT a procrastinator. After all, you are a motivated, high achieving individual who is focused and driven and who has taken the initiative to own and operate a successful business.

The fact of the matter is that the day to day management and operation of a business is all consuming, leaving very little time for long range planning. However, it is this failure to adequately plan for the future and unforeseen contingencies that often trips up business owners. For the future and long term success of a business each owner of a business should focus first on the following question: <u>Do you have a written buy-sell agreement in place that addresses what will happen when an owner departs from the business?</u> The reality is that there will come a point in time when either you or another owner of the business will no longer be a part of the business, whether by choice or otherwise. If you plan ahead now by preparing a written buy-sell agreement which outlines and details what will happen to each owner's interest in the business upon departure, you will greatly minimize the chance for disagreement among the owners at the time of the departure. Such proactive planning could save both you and your company time and significant expenses (especially legal expenses) in the future.

A buy-sell agreement should address the following situations: death (of yourself or another owner), disability (of yourself or another owner), a dispute among the owners (if the owners are in disagreement as to how to operate the business and want to divide the business), and voluntary departure (if you or another owner would like to leave the business for any reason). It is important that the owners have a plan in place which contemplates each one of these contingencies.

Is your company prepared to handle the death of an owner? Failure to adequately prepare for such an event could result in the deceased owner's family inheriting an ownership interest in the company, and as such exercising any and all rights in the company that were previously afforded to the deceased owner. This puts you in the position of having to own and operate the company with inexperienced owners who will likely not be knowledgeable about the affairs of the company. If you are thinking – no problem, I will just buy them out, you need to consider the following scenarios. What happens if they do not want to sell? Without a buy-sell agreement, you cannot force them to sell their ownership interest to you. In the alternative, if they do want to sell, how can you be certain they will sell the ownership interest in the company to you and not to a third party?

Typically, there are two types of provisions that are used in buy-sell agreements to protect the owners and the company in the event of either the death of an owner or the disability of an owner: the cross-purchase provision and the stock redemption provision. In a cross-purchase provision, each owner of the company purchases a life and/or disability insurance policy on the other owners in which the purchaser of the policy is both the owner and the beneficiary. Upon the death or disability of an owner, the proceeds from the insurance policies are then used by the other owners to purchase the deceased owner's interest in the company. In a stock redemption provision, the company owns life and/or disability insurance policies on each of the owners. Upon an owner's death or disability, the company uses the insurance proceeds to redeem the deceased or disabled owner's interest in the company.

There are also many other important factors to consider when preparing a buy-sell agreement. For example, how will the value of the ownership interest be determined? If the owners are in disagreement and want to divide the business, or if an owner wants to leave the business, what is the payout time for buying out an owner? Should the departing owner be required to first offer his or her ownership interest to the company or to the other owners – or can the departing owner sell his or her ownership interest to any third-party? Should the buy-sell agreement contain a covenant not to compete which would prevent a departing owner from directly competing with the company for a certain specified time period? These are just a few of the issues that should be addressed in a well drafted buy-sell agreement. It is vitally important to take the time to address these issues now, rather than leaving them to be resolved by chance (or by a judge) in the future.

If you do not have a written buy-sell agreement, you might be putting "off until tomorrow what you can do the day after tomorrow". Just keep in mind that the day after tomorrow is going to arrive at some point and often times sooner than you think. Are you prepared?