



Mistakes in Buy/Sell Agreements

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The buy-sell agreement arguably is the most important legal agreement for closely-held entities. The items listed are not necessarily in the order of importance—they're all important. For more detailed discussion, call and ask for our report "Top Ten Mistakes in Buy/Sell Agreement". Better yet, attend our "Understanding Buy/Sell Agreements" Workshop, where you can receive the report and learn much more about the red flags inherent in Buy/Sells.

- 1. Failure to Coordinate.** It is important to review governance documents, such as articles of incorporation/organization, and loan documents or other significant contracts, to determine how they affect the buy/sell agreement.
- 2. Improper Selection of Form of Buy-Sell Agreement.** Selection of the wrong form can create unintended and unwanted results. Consider the various scenarios causing triggering events under the agreement to make sure that the parties' real desires are not thwarted.
- 3. Improper Selection of Buy-Sell Agreement Triggering Events.** If the buy-sell agreement doesn't cover a particular event, the owner or the entity may have no rights in such a situation. Consider the possible applicability of triggering events beyond death and disability. For example, what if one owner loses a professional license or is otherwise no longer qualified as an employee?
- 4. Rights and Obligations Following Occurrence of a Triggering Event.** The consequences of a triggering event can run the gamut—from no action at all to mere notice to mandatory liquidation—and all points in between! Take care to track through the rights and obligations for the hypothetical occurrence of each triggering event to make sure that these rights and obligations are appropriate.
- 5. Valuation Headaches.** The uncertainty of future value often seems to make clients minimize the importance of the valuation of a business interest in the event of the exercise of a purchase right or sale right. Be sure to ascertain the standard and level of value for the interests. If a formula is used, understand the formula's basis, play out the scenarios, and try to develop a backup method.
- 6. Duties to Fund.** Parties must consider payment sources while they are putting together a buy-sell agreement. An unfunded buy-sell agreement may be a bigger problem than no buy-sell agreement at all. Make sure the owners have identified funding sources and that those sources, such as life insurance, are properly aligned with the people who will be entitled/obligated to purchase.
- 7. Financing Terms.** Many buy-sell agreements contain installment payout plans for payments of purchase price that exceed life insurance. In determining the details and flexibility of installment payments, pay close attention to the size of the projected installment payout relative to the amount of the currently available cash flow from the person who is entitled/obligated to purchase.
- 8. Failure to Coordinate Related Properties.** Sometimes the business is dependent on related properties not owned by the business. Related property can include life insurance policies on the life of the selling owner, interests in land (such as property on which a business operates), intellectual property, leases or other contractual obligations. It is important to analyze the subject company to see if it is reliant upon property that is owned by others and the terms of that arrangement.
- 9. Failure to Put it All Together.** Many, if not all, of the preceding points are interrelated. For example, selection of a triggering event must be carefully coordinated with the rights and obligations that are triggered by that event. Those rights and obligations must in turn be carefully coordinated with the terms of installment payout for any purchased interest. Don't neglect to look over the document as a whole and mesh it with the owners' objectives and circumstances.
- 10. Using a Cookie Cutter Approach.** Buy-sell considerations differ from business to business and even from owner to owner. Be sure the agreement reflects those unique circumstances.