THE VELD GROUP VELD MERGERS & ACQUISITIONS

Does Your Buy-Sell Cover Everything it Should?

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In this issue, we'll look at the events that can (and do) crop up in the life of a business and that can be handled by a carefully designed, frequently updated buy-sell agreement. Once you see how one agreement can impartially and fairly treat all parties when bad things happen, we think you'll make that call.

Transfer Events

Buy-sell agreements can be designed to handle the unhappiness that can arise when any of the following events happen to the shareholders of a closely held company:

- Death of a shareholder
- Disability of a shareholder
- Divorce of a shareholder
- Bankruptcy of a shareholder
- Sale of part or all of the company to a third party
- Retirement of a shareholder
- Involuntary termination of a shareholder
- Business dispute among shareholders

You probably have no trouble imagining how most of these events (the death or disability of a shareholder, for example) could cripple your company or your family if left unaddressed. But some events, like the involuntary termination of a shareholder, are harder to grasp. Rarely do owners anticipate that one day they might have to terminate the services of another shareholder. If they can imagine that scenario, it is rarer still that they can imagine the thorny problems that will arise. Is the terminated shareholder required to sell back his stock? Is the remaining shareholder or the company required to purchase it? In a divorce scenario (especially in a community property state) do you run the risk of ending up with your co-owner's ex-spouse as a new co-owner?

Let's look at a few all-too-common problems that well-written buy-sell agreement can solve.

Sale of Part or All of Company to a Third Party

You receive a call from a legitimate representative of a deep-pocketed Private Equity Group who has identified your company as an acquisition candidate. He makes an initial offer that would guarantee your family's financial security for life. Imagine your surprise as your 25 percent co-owner responds to your announcement, "Thanks, but no thanks. I'm just getting started and think we can take this company to the next level ourselves!" You call the PEG back to offer your stock for sale, but the PEG (like almost every third party owner) isn't interested in buying a part of your company. It is an all or nothing offer. Since your buy-sell agreement doesn't address this issue, you hang up and return to work.

A well-crafted buy-sell agreement can stipulate that when a third party makes an offer to buy a company's stock, the other shareholders must match that offer or must sell their shares to that third party.

Firing a Shareholder

Twenty years ago Ned, Kathy and Jim left a common employer and started their company. The three equal shareholders knew exactly what they'd do differently and agreed on how hard they'd all work to reach their common goals. During the last five years however, Jim's behavior was becoming unpredictable. He missed important customer meetings, ignored his department's performance and finally, was arrested for soliciting an undercover policewoman in a well-publicized sting. In an attempt to calm vendors and customers and to restore employee morale, Ned and Kathy asked Jim to resign. He refused. They reluctantly told Jim that he'd have to leave and that they'd purchase his stock at the value agreed upon in the buy-sell agreement. Jim pointed out to his co-owners that their buy-sell agreement did not mention the involuntary "retirement" of a shareholder and refused to sell his shares.

A carefully considered buy-sell agreement can stipulate not only that a fired shareholder must sell his or her shares for the agreed upon value, but also that the remaining shareholders must pay for that stock.

Divorce of a Shareholder

When Mike and Patrick went into business 15 years ago, they agreed on everything — except women. Neither could imagine what the other one saw in the other's wife, but had managed the situation by maintaining a polite distance.

One Saturday night, Mike called Patrick to ask if he could stay at Patrick's house because his wife had kicked him out. The following week, Mike was served with divorce papers and within days, Mike's attorney scheduled a meeting with both men. Patrick's initial curiosity about why he was involved turned to anger when the attorney told them that Mike's wife wanted, and, in their community property state had a right to, half of Mike's share of the company. If the three of them couldn't run the company together, Patrick would have to buy both of them out and Mike's wife had an especially unrealistic idea of what her share was worth.

Mike and Patrick turned to their buy-sell agreement hoping they'd thought to plan for this event. They had not. Their agreement did not include a divorce provision.

We are happy to send you information about any transfer events that your buy-sell should cover.