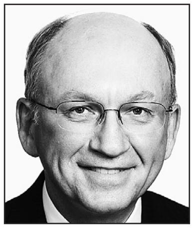
BUSINESS SUCCESSION

Be prepared with a buy-sell agreement

Business succession planning for a closely held business, like the making of a will, is important but easy to put off. A buy-sell agreement can be thought of as a business will, but unlike a personal will, a good buy-sell agreement is a multipurpose document that can provide for much more than who gets what after the death of an owner.



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While there are many variations in business ownership and management structure, smart succession planning documented in a BSA may benefit any closely held company by:

- Providing a market for the sale of ownership interests.
- Establishing a procedure for determining business valuation.
- Planning for tax consequences of ownership transfers.
- Prohibiting unwanted ownership transfers.
- Providing ownership incentives for key employees.
- Preserving voting and other special rights for founders during ownership transition.

There are six elements of a BSA:

Triggering events. Triggering events include death, disability or retirement of an owner or termination of an employee-owner.

Upon the occurrence of a triggering event, the buy-sell agreement typically provides for an optional or mandatory sale of the affected owner's interest and includes details regarding the buyer, purchase price, closing terms and means of funding.

Purchase price and valuation. The purchase price for an ownership interest sold pursuant to a BSA is often based on the value of the company at the time of the sale. Commonly used methods for valuing the company include: book or adjusted book value, an earnings formula, fair market value determined by appraisal, or the most recent value as agreed by the owners. Discounts or premiums may or may not be applied.

The "best" valuation method for a particular business depends on the nature of the business and the objectives of the owners.

Funding. In case of the death or disability of an owner, funding of the purchase price may be accomplished by insurance, which raises a number of tax and non-tax issues, including policy ownership, whether to structure the sale as a redemption by the company or a cross-purchase by the other owners, responsibility for payment of premiums and disparity in amount of premiums or availability of coverage. Alternatively, the buy-sell agreement may provide for a payment of some cash at closing with the balance of the purchase price being deferred and evidenced by a promissory note. In this case, the agreement should specify payment terms, interest rate, maturity date, security for payment and remedies in the event of default.

Restrictions on transfer. The buy-sell agreement can take various approaches to voluntary transfers of ownership interests, including:

- Prohibiting any transfers without consent of other owners.
- Permitting transfers to family members or specifically designated persons or trusts.
- Subjecting transfers to a right of first refusal.
- Prohibiting any transfer that would cause an involuntary termination of a corporation's "S" election.

Governance and special rights. The buy-sell agreement provides opportunities for flexibility and innovation with regard to company governance. For example, it may be desirable for founders to have special veto or approval rights, or to have a founders' premium added to the purchase price formula as a reward for taking the initial risks and establishing the business. Other special rights or provisions may include:

- Approval of specified matters by super-majority vote.
- Procedures for resolving a deadlock.
- "Drag-along" and "tag-along" rights in the event of a sale by an owner to a third party.
- "Put" rights requiring the company to buy an owner's interest.
- "Call" rights requiring an owner to sell to the company after a certain event or period of time.

Employee-owners. It is often advisable to require employee-owners to sell back their interests upon termination of employment, perhaps at a discounted purchase price if the employee-owner quits or is terminated for "cause."

Employee-owner BSAs typically also include covenants regarding non-competition, non-solicitation and confidentiality.

Waiting for a transfer event to occur without a plan for dealing with it is a recipe for disruption, if not disaster. Regardless of the makeup of a closely held business, the benefits of a carefully considered and clearly drafted buy-sell agreement will greatly outweigh the time and cost of preparation.

And as with a personal will, you and your "business family" will rest easier.

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