



ASPEN FAMILY BUSINESS GROUP, LLC

DEEP RELATIONSHIPS. ENDURING LEGACIES.

Your Buy Sell Agreement: An Asset or A Liability

by Aspen Family Business Group, LLC

With all the talk of impending tax law change swirling around the advisor community, we still have little certainty as to when and how income, capital gains, and estate tax law will change. Congress with elections bearing down on them seems locked into camps that allow little maneuver room for compromise and settlement. With that scenario in mind, the lame duck Congress late this year and the expiration of the Bush tax cuts, appear to be the wild cards resulting in this feeling of uncertainty.

With that being said, let's examine an agreement that can and should provide certainty of results, but often, due to a lack of attention and review, results in unintentional and litigious consequences. That document is a Buy Sell Agreement. A Buy Sell Agreement documents the terms and conditions for a sale of business interests under given triggering events. For example, a death of a shareholder would trigger a purchase of the shareholder's stock. The Agreement defines how the stock is to be valued; therefore, the price to be paid, how the payments are to be made (cash or a note), terms of the note, and what collateral stands behind the note payment.

The triggering events should at least address death or disability of the shareholder, termination of employment, and what happens in the event of a divorce. Other events such as a sale of the entity may also be addressed through devices known as "drag-along" and "tag-along" language to protect shareholder positions in a sale transaction.

Each Buy Sell requires customization to fit the facts and circumstances of the business and the shareholder's goals and objectives. Often when an "off the shelf" Buy Sell from an Insurance Company's legal department or other common source is employed without modification, the result is not that which is intended. The second major reason that Buy Sell Agreements fail to accomplish the objectives of the shareholders is lack of timely review and attention. The Buy Sell Agreement and its funding should be reviewed at least annually. This review

should consider if the original objectives are still valid—are there new shareholders or family members who have joined the firm or might desire to be shareholders? Is the valuation or the formula for valuation still valid? Is the funding, if any, adequate and appropriate? If there is no funding, is there adequate cash to cover the payment due to shareholders?

These are but a few of the questions that should be evaluated in the annual review and appropriate action should be taken to update to the current situation. An example of an almost unintended consequence occurred recently in a software company in the southeast. The company is owned by three relatively young entrepreneurs with the majority held by one of the three. The company is growing at a legitimate 30% per year. A Buy Sell Agreement has been in place for several years, but unfortunately the valuation formula did not reflect the growth of the company nor the potential in the market they have developed.

The almost unintended consequence occurred when the majority shareholder suffered a life-threatening medical event. While recovering he thought about the Buy Sell Agreement and had it reviewed. What he found was what he feared. The buy-out price for his stock was about 20% of the real fair market value. Had he not recovered from his event, his family would have been deprived of much of the value that he, as one of the key drivers in the business had created. His partners on the other hand would have had a windfall.....certainly not their intent when they created their agreement.

The story is progressing happily as they have now re-drafted their agreement to reflect their current situation and fair market value and are in the process of realigning their funding so as not to burden the company should another event occur.

In future Newsletters we will address other applications of Buy Sell Agreements that are useful in aligning family business ownership with the Wealth Succession Goals of the Family. Such agreements can be very useful tools to avoid family conflict by providing very clear direction reflecting the objectives of the family. In summary, if you have a Buy Sell Agreement in place, pull it out of that dusty file, read it and see if it still reflects your current wishes regarding the passage of ownership of your interest. If it doesn't, talk with your advisors and ask them to work with you in bringing it up to date. You never know when one of those triggering events could occur!