# BUY-SELL AGREEMENTS ARE JUST SMART BUSINESS

## Protect Your Share – and Your Heirs – With a Buy-Sell Agreement

BY RICHARD LUTRINGER

THERE ARE SEVERAL REASONS WHY YOU as a small business owner, need a buy-sell agreement. One reason may be to specify what will happen to your share of the business if you should die. Another reason is to protect yourself in the event of a disagreement or dispute between you and your partner (or partners), in which case a non-death option should be addressed ahead of time. Whatever the reason, having a buy-sell agreement is simply smart business.

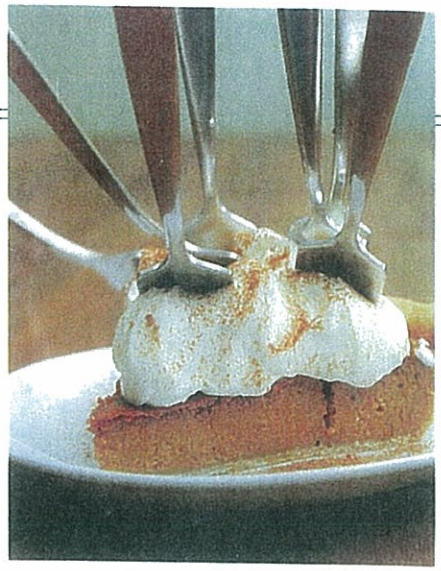
In one real-world example, when one of the three owners of a trucking company had a heart attack at 58, his widow expected to get her husband's proportionate share of the fair value of the business. But the two surviving owners did not want to borrow money to fund the purchase of the deceased's shares.

In New York State, as in most states, when there is no buy-sell agreement with regard to the shares of a corporation upon the death of a shareholder, there is no duty for the corporation or the other shareholders to purchase the deceased's shares. The widow's options in the trucking company case were extremely limited, since neither one of the surviving owners or the company itself had any contractual obligation to dissolve the company or buy her husband's interest in the business. Without illegal, fraudulent or oppressive actions by the controlling shareholders, or unless the shareholders have been unable to elect directors for at least two years, a minority shareholder of a New York corporation has no right to force a judicial dissolution, much less demand a buyout. In this scenario, since the two surviving owners owned 66% of the shares of the company, they were not obligated to purchase the widow's shares. Since the shares had no current value, the widow was effectively locked in as a passive minority investor in a business that traditionally paid no dividends.

In need of cash, the widow consulted with her attorney and sold her late husband's interest in the company for a 35% discount off the lower end of the range of one third of the business' fair market value, in accordance with a standard formula suggested by her tax accountant, payable one third up front and the remaining two thirds in monthly installments over 10 years.

It's not just shareholders of corporations who need to take care of themselves at an early stage. Judicial dissolution of a limited liability company (LLC) can be even less predictable since under New York LLC law a judge must be convinced that it is not "reasonably practical" to carry on the business of the LLC. There are few precedents in case law for what is or is not "reasonably practical" in such cases. The reality is that it is not easy to get New York courts to order dissolution of either a profitable, ongoing corporation or LLC without proof of an immobilizing deadlock or serious management or shareholder misconduct (which does not include refusal to buy shares from the estate of a deceased shareholder).

Death and disability are not the only things that create owner buyout issues. Disputes can also arise when one or more stakeholders voluntarily decide to go their separate ways — for example, when one major shareholder intends to set up a new business and there is no pre-existing agreement as to how the current business is to



be divided with regard to assets, customers, ongoing work or existing office leases. Even if the parties are not hostile to each other, the question of how to distribute the assets and liabilities fairly and efficiently with the least disruption to ongoing work and customer relations can be a major challenge. If not handled carefully, a situation like this can easily end up in litigation — usually a lengthy, expensive and emotionally draining process that can quickly reduce the size of the assets to be divided and leave the parties alienated. [See box on page 30 regarding the use of mediation to resolve these issues.]

What are the basic elements of buyout provisions in a shareholder agreement or LLC operating agreement? The key questions such clauses cover are "if, when and how much."

**"If" — The Triggering Event:** Typically, the triggering events for a mandatory buyout of a shareholder/LLC member's interest include, at a minimum, death, incapacity and bankruptcy of the owner. In most cases involving small businesses, shares are non-transferable. However, exceptions are made for the transfer of shares to immediate family members. Most non-related partners, however, don't really want the children or spouse of a deceased co-shareholder as their

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