



Exit Planning Information & Education for America's Business Owners

The Exit Planning Review™ is an opt-in, bi-monthly newsletter published by Business Enterprise Institute, Inc.

This issue is provided to you by Joe Durnford.

PROVIDED BY:

Issue 119

Business Continuity Agreements

Even More Reasons for a Well-Crafted Buy-Sell Agreement: Part II

In the last issue, we introduced you to the business continuity agreement and we discussed how this document can be one of the single most important items that you, as a closely held business owner, will sign. We also outlined some of the many advantages of a business continuity agreement (also called a buy-sell agreement) in regard to establishing transfer to ownership, valuation techniques, and terms and conditions.

We will continue the discussion of buy-sell agreements in this article by looking at how these agreements can protect rights among shareholders, provide a means for joint owners to get on the same page in regard to the future of the business, and establish a market for an owner's stock at an agreed-upon price.

Buy-sell agreements establish and protect rights among shareholders that do not otherwise exist in the company.

Through a buy-sell agreement, a minority shareholder may attain more control over his or her destiny than is normally provided through voting rights. These safeguards may include placing limits on the sale or purchase of the stock of the majority owner(s), establishing valuation of all owners' stock, giving minority owners the right to sell their stock if certain events occur, and other important items.

An example of the type of right that a buy-sell agreement can establish is providing the owner of a minority interest the right to serve on the board of directors. Obviously, this can be an important right because a minority shareholder might not otherwise be able to garner sufficient votes to be elected to the board.

A second example is requiring the corporation and remaining shareholders to do their best to obtain the release of the departing shareholder from any personally guaranteed indebtedness, as well as to release any personal collateral used for a corporate debt when the owner of that collateral sells his or her interest in the company.

Recall Tom Gardner from the hypothetical case study we discussed last issue. As a minority owner, he was unable to buy control of the company and was unable to prevent a new majority owner from exercising total control over the company. A buy-sell agreement could have prevented that.

An intangible benefit lies in the process of designing the buy-sell agreement.

All too often when there are joint owners of a business, they do not sit down together to discuss business issues. In order to draft a buy-sell agreement, a meeting of all owners is essential. In doing so, they address major questions affecting their relationship such as: What happens if one of the owners dies?

What happens if the owners don't get along? What happens if one wants to retire before the other? Obtaining answers to these important questions requires owners to discuss their ideas about the future of the business.

For an example of this, let's look at the hypothetical case study of John and Steve, both equal partners in a manufacturing business.

John and Steve had a poor relationship and they were certain each had opposing views on the future of the business in terms of both growth and their respective desires to remain in the business. They each also had their own ideas about their own importance to the business.

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