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Buy-sell agreements eliminate bitter, costly disputes

When a company and get started in their new business, opportunities to make opportunity are usually in full supply. At that point, it is only natural to avoid thinking about some difficult questions about the business. One key, and all too frequent mistake, is the failure to discuss and plan for how a business owner leaves the company. Unfortunately, this often leads to some of the most bitter, confusing and costly disputes among business owners.

Whether your company is a corporation, limited liability company (LLC) or any other organization, it is important to formulate and document a plan for how business owners will leave the company — preferably at the time the company is formed. It may seem a little like planning for divorce on your wedding day, but a plan for a smooth transition of ownership in these instances will save time, money and headaches later.

Usually, a buy-sell agreement (sometimes called a shareholder agreement) is the document which addresses these issues. The best time to execute a buy-sell agreement is at the time the company is formed, though it can be executed among owners at any time. The difficulty in doing so well after the company's formation is that it may prove more difficult to get owners to agree on exactly how these terms should work several years into the venture.

A well-written buy-sell agreement will

define a plan for dealing with a range of issues, which may include: (1) a restriction on the transfer of ownership rights without first offering it to other owners and to the company itself, (2) certain transfers of ownership rights which may be permitted without approval (e.g., such as transfers to close family members, related companies, and so forth), (3) protections for minority owners such as so-called "tag along rights" that provide that majority owners can't sell their ownership interest to a third party without also getting the third party to buy out the minority owner's interest, and (4) protections for majority owners such as so-called "drag along rights" which allow majority owners to sell membership interests to a third party and prevent a minority owner from holding out on the sale of 100 percent of the company's ownership interest.

Buy-sell agreements will also address what happens when an owner dies, becomes incapacitated, gets divorced, or declares

bankruptcy. In these cases, having an agreement that defines an orderly transition avoids undesired results, such as a deceased owner's interest in the company passing to his family member who is not capable or interested in participating in the business.

Of course, in many of these cases a key factor is how to determine the value of the ownership interest to be purchased or sold. A valuation of the ownership interest in the business may utilize appraisers, an objective formula based upon known criteria, or simply establish a fixed price. The price may be paid at once or over a specified amount of time. While there are endless variables, the key is that the buy-sell agreement sets forth the plan clearly so that the parties can have a defined, orderly transition.

Obviously, the best plan for buying a party's interest is only as good as the ability of the purchasing party to pay for the ownership interest. As a result, many buy-sell agreements will have requirements designed to ensure that whenever a triggering event occurs, the business or owners will have the cash necessary to buy out the ownership interest. For example, a buy-sell agreement may provide that an owner have a life insurance policy in place with the company as the insured. That way, if the owner dies, the company uses the life insurance proceeds to purchase the deceased owner's interest and keep the remaining owners

from having to deal with the deceased owner's family members.

Agreements also are particularly important where voting deadlocks can occur. A well-written buy-sell agreement provides a mechanism to permit owners to break the deadlock, possibly through a buy out process intended to separate the owners who are deadlocked. The alternative would be a judicial dissolution, which means a court ordered fire sale of the company's assets likely for pennies on the dollar. Buy-sell agreements are many times used as integral parts of business succession plans or estate plans. Finally, because Wisconsin is a marital property state, buy-sell agreements must also address the rights of spouses.

Buy-sell agreements are sometimes complex documents that are different for each case. To ensure your buy-sell agreement does everything you want it to, you'll want to enlist the help of a business attorney experienced in buy-sell agreements, preferably when you form the company or shortly after. It requires some planning and perhaps difficult conversations with your fellow owners at the outset of your business venture, but it can go a long way to preventing messy and expensive disputes later.

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