Does My Business Need (Or Need To Update) A Buy-Sell Agreement?

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When a business has more than one owner, we usually recommend that the owners and the company enter into a buy-sell agreement. A buy-sell agreement is an agreement that contains the terms and conditions upon which the owners of the company are required or authorized to sell their ownership interests in that company. These agreements can be in the form of a stand-alone document, such as a Shareholders Agreement, or incorporated into the terms of another agreement to which the company and the owners are subject, such as an Operating Agreement.

A good buy-sell agreement will serve several purposes. Primarily, it will provide for the orderly transfer of ownership:

(a) in the event an owner desires to sell or transfer their ownership interests; or

(b) upon the occurrence of certain pre-determined events where the parties believe it would be in the best interest of all owners and the business to require that an owner do so.

It will also give the parties control over who can become an owner, thereby preventing unwanted parties, such as ex-spouses, from becoming co-owners. A buy-sell agreement should also reduce the likelihood of disputes over a business's value when an owner exits, which is a common source of contention among the parties to such a transaction.

There are four primary components to a buy-sell agreement:

1. the events that trigger the application of the buy-sell provisions (which are often referred to as "triggering events"), such as death, divorce or bankruptcy, disability or incapacity, or termination of employment or retirement;
2. the parties who have the option or obligation to purchase the ownership interest upon the occurrence of a triggering event, who are usually the other co-owners and the company;
3. the price at which the ownership interest can or must be purchased, which is usually determined in reference to a formula; and
4. the payment terms for the purchase price, including the timing, number of payments, and interest rate, if any.

While a generic buy-sell agreement is usually better than no agreement, we advise our clients to carefully consider each of these components before entering into a buy-sell agreement. This is because the terms that are beneficial to one company and its owners are unlikely to be a perfect fit for another. For example, a third-generation family-owned business may desire the free transfer of ownership interests among family members while a technology start-up may want to prevent such transfers, retaining the ownership among only key employees. We also advise our clients to review and consider updating their existing buy-sell agreements, from time to time, as their businesses and ownership changes.