

An Overview to Buy-Sell Agreements

January 01, 2006

Andrew J. Sherman

Content provided by Kauffman eVenturing

The buy-sell agreement is a legal document that specifies how a company or its owners will redistribute ownership shares after one of the owners dies, becomes disabled, retires or otherwise leaves. The basis for the agreement is a contractual covenant by each owner (or the company) to redeem the stake of any owner who departs, eliminating many of the complications of having a surviving spouse (or even the entire family) at the ownership table.

The primary goal of the buy-sell agreement is to avoid conflict and confusion by keeping ownership and control in the hands of those individuals who will be responsible for managing the operations of the business. The ability of the remaining owners (or the company) to purchase the departing owner's shares must be provided for in some manner. This is typically accomplished through the purchase of a series of "key person" life insurance policies or some other reliable source, such as investment accounts specially designated for these purposes to ensure that cash will be available when the "triggering event" occurs. A "triggering event" may be death, disability, voluntary or involuntary termination (with or without cause), retirement, reaching a certain age, divorce, an acquisition or initial public offering, or some other change in personal, business or family circumstances.

In general, there are three basic types of buy-sell agreements:

- ***Cross-Purchase Agreements*** are ideal for partnerships and corporations with small ownership groups (up to three people). The remaining owners directly purchase the departing owner's ownership interest in the business, rather than doing it through the company.
- ***Stock-Redemption Agreements*** are simpler and easier to structure than cross-purchase agreements. This makes them best suited for corporations with four or more shareholders. The corporation redeems (directly purchases) the shares of the departing owner, and the remaining owners see an increase in the value of their shares, not the number of their shares, as in a cross purchase.
- ***Hybrids*** are combination arrangements that usually put the priority for redemption with the corporation, but the shareholders have the option of

directly redeeming a deceased owner's shares if the corporation is unwilling or unable to do so.

The buy-sell agreement is often challenging to address when forming or growing a company, but it is a necessity to discuss and implement to avoid conflict and confusion should a transition in ownership develop. To learn more about how to develop a buy-sell agreement and how other entrepreneurs approached developing buy-sell agreements, read more articles in the eVenturing Collection titled *Top Strategies for Buy-Sell Agreements*.

© 2006 Andrew J. Sherman. All rights reserved.

About This Item

Category: Strategic Planning

Subcategory: Business Lifecycle

Keywords: Buy-Sell Agreement, Legal, Ownership, Succession

Content provided by:



Geared to those who are building companies that innovate and create jobs and wealth, Kauffman eVenturing is the trusted guide for entrepreneurs on the path to high growth. The site provides original articles, written by entrepreneurs for entrepreneurs, and aggregates "the best of the best" content on the Web related to starting and running high-impact companies. eVenturing is a resource of the Ewing Marion Kauffman Foundation.

Contact: (816) 932-1000 or www.eventuring.org