

Of course we all agree, right?

Issues to consider regarding buy-sell agreements By Robert Zunich

“I thought we agreed on this.”
“We’ve known each other forever. I thought I understood what he meant.”

“I don’t remember agreeing to this!”
“We’ve agreed on everything else; how could this happen?”

Realizations like those expressed above are often heard from business owners when a transaction occurs subject to a buy-sell agreement. As such, let’s look at the issues involved and affected by these agreements.

A buy-sell agreement is often the centerpiece of a corporation’s, partnership’s or limited liability company’s business continuation plan and the owners’ estate plans. A properly crafted agreement with ongoing updates can provide stability to an organization, while poorly crafted, outdated or stale agreements can lead to disharmony, frustration and problems.

To begin, let’s look at the two general types of agreements.

- (1) a redemption is structured for an entity to repurchase shares
- (2) a cross purchase provides for the remaining shareholders to buy the departing shareholder’s shares

Many factors influence the crafting of an agreement. Here are just some of the issues to consider. As you read them, keep in mind “Of course we all agree, right?” and imagine the differences of opinion.

What entities are covered by the buy-sell agreement? Closely held organizations are often segregated into multiple entities for a variety of reasons. For example, real estate is often owned by an entity outside the operating company. Planning and consideration should include all entities in the closely held group, keeping in mind that different entities may have different ownership percentages. Ideally, each entity would have an agreement, with the overall transaction being contemplated in aggregate.

What drives the valuation method for ownership interest? Many agreements refer to a business appraisal, asset appraisal or fair market value. However, parties to the agreement often don’t fully understand these terms. Issues of minority and mar-



ketability discounts, management of earnings, related entities, future capital expenditures and working capital requirements can significantly affect the range of value. Variation in value of 25 to 50 percent is not uncommon. Information is the key to understanding this part of the agreement. Consultation with a certified business valuation professional is time well spent.

How does the transaction affect the ownership of the entity? Let’s look at a hypothetical entity owned by three shareholders – Shareholder A owns 20 percent, Shareholder B owns 35 percent and Shareholder C owns 45 percent. In the current scenario, no single shareholder is a majority owner of the entity. Assuming Shareholder A is redeemed in a repurchase transaction, the entity is now owned 43.75 percent by B and 56.25 percent by C. The transaction resulted in Shareholder C becoming majority owner of the entity. The impact to the stakeholders should be planned accordingly and not accidentally.

How will the repurchase or cross purchase be paid for? The parties may agree to how much, but do the entity or co-

owners have the ability to fund the transaction? It is also important to recognize that life’s unexpected events may trigger multiple transactions within a short period of time or in a different order than planned.

If these are just a hint of some of the issues associated with a poorly crafted, outdated, stale agreement, imagine the issues that could arise if no agreement exists. How do you know what pitfalls might be coming your way? To start, read your current agreement and make sure you understand all the language. Seek advice from your legal, accounting and valuation professionals. Most importantly, schedule an owners meeting to discuss the transactions and see if you all agree.



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