



Exit Planning

NAVIGATOR

Exit Planning Strategies for the Entrepreneur



Issue 65

Business Continuity

Lifetime Exits - Part 2

For the last several issues, we have discussed various business continuity solutions to the problems that arise when an owner dies. In the issue just before this one, we introduced the idea of using business continuity planning to resolve the ownership transfer events that can occur during your lifetime. These issues include:

- Permanent disability
- Sale to an outside party
- Retirement
- Termination of employment by Company
- Involuntary transfer due to Bankruptcy or Divorce Decree
- Dispute between or among owners leading to sale of ownership

The first issue, permanent disability, is usually funded by insurance. In this way, it is very similar to the death of a shareholder. As you plan for this possibility, you may have to spend time carefully defining "permanent disability" so that your company does not suffer from an owner who doesn't realize how incapacitated she really is.

Our goal here, however, is to discuss events that are not funded by insurance; for example, the bankruptcy or divorce of one of the shareholders. In the event of one of these involuntary transfers, the shareholder could be forced to transfer his ownership interest (in the case of bankruptcy to the bankruptcy trustee or creditor or in the case of divorce, to the former spouse.) You may want your buy/sell agreement to simply give the business the opportunity to acquire the shareholders' stock. You may insist on creating this provision when you contemplate the prospect of having your co-owner's ex-spouse as your new co-owner!

Several of the lifetime transfer issues listed above are voluntary because they are in the control of one or more of the shareholders. For example, if there are two equal owners, one of whom is President, you may want your agreement to prevent the President from being able to fire the other owner. Imagine instead that there are three equal shareholders. Two of them would generally have the power to fire the third. In that event, the two might want the ability to purchase the terminated owner's stock. The fired owner may want the ability to sell his stock back to the company. Or, all owners may simply want the agreement to require a mandatory purchase of stock in the event of termination of employment of a shareholder for any reason, whether he quits or is fired.

To those owners who resist spending the time and money to think about these issues and to create a buy/sell agreement to address them, we ask if they have imagined what the litigation (that will arise in these situations) will cost, both financially and emotionally. To agree upon a means of assessing fair market value, the buyout terms and conditions before tempers flare and in advance of any need, can truly be a godsend.

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Finally, let's look briefly at the sale to an outside party. Every buy/sell agreement should include restrictions on transferring stock to non-owners. Without this provision, the agreement is toothless; an owner would be able to transfer his stock to anyone, at any time, thereby avoiding the agreement's primary purpose of restricting ownership to current owners.

If ownership interest is to be offered to an outsider, the agreement normally requires the owner to first offer his interest to the company, then to the remaining co-owners at the same price and terms offered by the would-be buyer.

Often the agreement requires that the purchase price offered the remaining owners be the lower of the value set forth in the agreement or the price offered by the would-be purchaser. This assures the remaining owners that they need pay no more than the value fixed in the agreement.

Some readers may be wondering how to handle these matters when there are two or more non-controlling (usually equal) owners. Neither may be able to fire nor get rid of the other unless there is a special provision in the buy/sell agreement. In our next issue, we will look at this provision, one fondly referred to as "The Texas Shootout."

Subsequent issues of The Exit Planning Navigator® discuss all aspects of Exit Planning.