NC STATE EXTENSION

What is a “Buy Sell” Agreement

Robert Andrew Branan, Extension Assistant Professor
Department of Agricultural and Resource Economics, CALS, NCSU
rabrna2@ncsu.edu

A buy-sell agreement is a contract creating an option for one business owner to buy all or a portion of the business (which includes its assets) upon the retirement, death, divorce or disability of another business owner. Such agreements are often found as clauses in the governing documents of business entities such as limited liability companies to restrict ownership of business interests. Sometimes they are stand-alone documents added later to an existing business by agreement of the owners, such as a stock purchase agreement for an existing corporation.

The buy-sell agreement specifies who can buy the ownership interest, how the purchase price will be set and paid and at what interest rate. Terms of the sale and when the sale will occur are also included. Funding of the purchase can be an important consideration in drafting an agreement, and is usually accomplished with business cash flow, loans, life insurance proceeds or through the sale of other assets.

A buy-sell agreement allows the owners of business interests to agree ahead of time how to establish the value of the company and the value of ownership interests in a mutually beneficial agreement for all owners and their families. Such agreement helps to reduce uncertainty about what happens in the event tragedy befalls an owner. The agreement minimizes disruptions to the business operations after an owner’s exit because the general circumstances of the exit have been contemplated ahead of time by all parties in interest.

Planning for the future of a farm or forest landholding in this way assures the business’s stability and continuity and provides investment-decision stability for the purchasing owner and perhaps other key employees. If the buy-sell agreement covers land, it manages the risk that others - such as off-farm heirs - may gain an ownership interest and have different ideas about the use or disposition (ie. sale) of the land. In this form it is sometimes used to allow other heirs to participate in the equity of the land without ultimate control over disposition.

A common form of buy-sell agreement in limited liability company can work this way: One owner suffers a triggering event, such as death, a disability, files for divorce or files for bankruptcy, or a desire to leave the business, thus exposing ownership of his or her interest to third parties not chosen by the remaining owners. The agreement requires him or her (or his or her representative) to notify the other members in a specified manner, which starts a clock. The business itself may have the first option to purchase the business interests of the departing member. In the case of death of a member, the company may have purchased a life insurance policy on that member and the agreement may require that the company purchase the interest. In the absence of such requirement, if the business fails to exercise its option within the time period, the next option may fall to the remaining owners to purchase the shares, and if more than one steps forward, they can purchase a share commensurate with their then current percentage of ownership.

Agreements can identify future purchasers by name, which may be useful when a current user of the property - such as a successor manager of the land - needs assurance that he or she will have the resources to operate in the future, thus giving them confidence to continue investment in enterprises. Often this option is opened to the identified person's lineal descendants where it is important to keep land in the family.

An option holder usually has no right to force the sellers to give up their property, only the right to be the first in line to buy the property if the sellers decide to put the property on the market. The option holder cannot guarantee that the business interest will be put up for sale at a time where the option holder is able to cash flow the sale.

Rights of first refusal may also be written into a trust or recorded as stand alone documents with the county register of deeds. Such an option would normally be triggered when a Trustee or owner decides to sell a certain piece of property, such as land. If such an option is drafted into a trust, care should be taken to spell out how the price will be set along with the terms of sale. Trustees are bound by law to maximize the return to beneficiaries of the trust in the absence of any limiting language in the trust agreement. A specific person may be given the first option to purchase property from the trust of the deceased with the trust, and thus the beneficiaries, receiving the proceeds from the sale.