



COMMERCIAL LAW

Buy/Sell Agreements.

*Compulsory share sale on
death or permanent injury.*

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Critical events.

It is important to consider what will happen to the business, and the shares in the company, in the event that one of the shareholders suffers from death, disablement or another illness or injury (a “critical event”) that prevents them from returning to the business.

Currently, if one of the parties suffer from a critical event and do not have an agreement with the other shareholders about what will happen to their shares, it is possible that:

- 1.** The shareholder will be left with their shares in the company but unable to work in the business. In the event they want to sell their shares, the other shareholders may not have sufficient funding to buy them; or
- 2.** In the event that a shareholder dies, their shares may be dealt with in accordance with the terms of their will and left to their estate and the beneficiaries of your estate. Accordingly the remaining shareholders may be left in business with the deceased’s spouse.

These scenarios can be potentially damaging to the business. It can also leave the other shareholders with an arrangement that they did not intend when they joined the business.

A way to protect against the above scenarios is to take out insurance protection and for the shareholders to enter into a “Buy/Sell Agreement” (sometimes referred to as a “Compulsory Share Sale Agreement”).

Insurance.

Generally, there are two main types of insurance that should be considered:

- 1.** Key Person (or “Key Man”) Insurance – this type of insurance allows the business to cover its costs in the event that a person who is fundamental to the business suffers a critical event. It can cover costs such as staff replacement costs, training costs and loss of profits; and
- 2.** Life, Trauma and Disability Insurance – these types of insurances are usually triggered when a shareholder suffers from a critical event and has to leave the business. The insurance will usually pay a lump sum to the remaining shareholders of the company, allowing them to buy out the shareholder and may in some cases, pay out the current account of that exiting shareholder.

We always suggest consulting with a specialist insurance broker about what insurance arrangements will be best for your business.

Buy/Sell Agreement.

A Buy/Sell Agreement outlines the process to be followed in the event that a shareholder suffers from a critical event. It specifies that the insurance proceeds must be used to purchase the exiting shareholder's shares in the company.

The Buy/Sell Agreement will usually cover points such as:

- 1.** Ownership of insurance policies: Shareholders usually arrange for the insurance policies to be held on trust for the shareholders by an independent third party. Having an independent person involved to receive and pay out the insurance proceeds can relieve some of this stress and help ensure the process runs smoothly.
- 2.** Payment of insurance premiums: The insurance premiums may be paid by the shareholders of the company, or the shareholders could require the company to pay the insurance premiums.
- 3.** When a share sale will be required: What events will trigger a share sale under the agreement will depend on what type of insurance has been taken out by the shareholders. A pay out under an insurance policy may be triggered by events such as the death of a shareholder, the total and permanent disablement of a shareholder or when a shareholder suffers a critical injury or illness preventing them from returning to the business.
- 4.** The share sale process: The agreement will outline how the shares are to be sold to remaining shareholders, including when settlement will take place, and what documents and conditions are required to complete the share sale.
- 5.** The sale price for the shares: The agreement will also outline the price to be paid for the shares. It could be based on a fair valuation, formula or on the value of the insurance proceeds that are to be paid out. It is best to seek accounting advice on this point before making a decision.

Buy/Sell Agreement can be relatively technical documents, but are important for protecting the business from an unexpected event to one of the shareholders.

Getting started.

If you would like to talk about buy/sell agreements feel free to get in touch.

We'd be happy to discuss your particular situation, what you're looking to achieve and how you might go about getting there.

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DISCLAIMER: The above article provides a general overview of compulsory share sale on death or permanent injury - Buy/Sell Agreements. It is not intended to be construed as legal advice. If you require any legal advice or further information about this article, please contact the team at Davenports Law to discuss.