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### **Partnership Change: Plan Ahead with a Buy Sell Agreement**

As the saying goes, change is the only constant. For a small business, partnership change—especially a partner leaving the business—could occur at some point.

This article addresses how your small business can plan for partnership change through drafting a buy sell agreement. A buy sell agreement (also called a buyout agreement) allows you and your partners to plan ahead for bumpy roads when a partner leaves the business.

There are always some partnerships that neglect to take on the simple yet necessary task of forming a buy sell agreement that will deal with changes in the partnership. These documents are often critical to the success and life of your business and should not be taken lightly or forgotten. By creating a buyout agreement with your partners, you will be prepared if one partner suddenly dies, wants to leave the business or gets divorced.

#### **What's a buy sell agreement?**

Whatever the name sounds like, a buy sell agreement does not deal with the buying and selling of partnerships. Generally speaking, a buy sell agreement (or a buyout agreement) is a contract between all the partners in a business that deals with the future ownership of the business and partnership change.

Because a buyout agreement is a binding contract, it can either stand by itself or it can be included inside of the partnership agreement. It should generally cover important business decisions, such as:

- Whether a partner can be bought out when he or she departs the business,
- The amount that an ownership interest will be valued at (called the valuation formula) when a partner leaves,
- Who can buyout a partnership interest when a partner departs (this can include outsiders to the partnership, but is often limited to pre-existing partners), and
- What events can trigger a buyout.

As some commentators have put it, another way to think of a buyout agreement is like a prenuptial agreement for businesses. Even though you may all think at the outset that the partnership will last forever, sometimes things happen that will break up the partnership.

#### **What events are covered under a buyout agreement?**

As noted above, a buyout agreement will generally spell out what kinds of events will trigger a buyout option. These events typically include:

- The retirement of a partner,
- A divorce settlement agreement in which a former spouse of a partner is going to receive an ownership interest in the business,
- An attractive and lucrative offer from an outsider to buyout a partner's interest,
- A foreclosure of a debt that was secured by a partnership interest,
- The filing for personal bankruptcy by a partner, or
- The death, permanent disability or incapacity of a partner.

#### **Why do I need a buyout agreement?**

Not only is a buyout agreement like a prenuptial agreement for businesses, it will also remind all the partners of how you have all agreed to handle the sale or buyback of an ownership interest in the event of partnership change. If you and your

partners do not have a buyout agreement, your partnership might have to be dissolved by the law if one partner decides to leave the state and start his own business in another. This would force you and your partners to divide all the assets of the business and start building from scratch.

Even if your partnership is not coming to an end, you and your partners may still disagree on who should buyout an ownership interest of a departing partner and how much the ownership interest should be bought for. There have been numerous legal battles over the valuation of an ownership interest at the time of sale because the business owners forgot to make a buyout agreement where they set a valuation formula. This could lead to costly litigation and business delays.

Lastly, buyout agreements also dictate what kinds of outsiders can buy into a partnership. If you do not have a buyout agreement in place, you may end up running your business with someone that is distasteful to you.

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