CHECK THE EXITS!

When you get on a plane, whether you are the pilot or the passenger, you make a visual check and a mental note of your exit plan in case of emergency. It doesn't take long and hopefully never becomes important — but you always do it. Likewise, when successful business owners 'step on board' and pilot their own business, they must understand the details of the key corporate documents that govern their exit rights. Where are the exits in your business?

Causes of Change

We know what events force changes in business ownership. Every one of them is a little unpleasant to think about and talk about: death; disability; a shareholder who wants out; a shareholder other shareholders want out. The loss of a key person, or conflict between key people present very different kinds of problems, but each can be helped or hindered by the agreements between the owners.

Active vs. Passive Ownership

Often in the startup of a business, each owner is active in the business and involved in the day to day minutia of getting the business off the ground. At times, it can be difficult to even conceive of the business having passive owners who are not so involved. In a more mature business, however, contentions between passive ownership and active ownership can take on great importance and strain prior arrangements making a buy-sell agreement even more important. Owners who are actively involved, sometimes even as employees of the business, can have a very complex relationship with other employees and with passive owners of the business, and often feel their 'sweat equity' is undervalued. Frequently, these formal arrangements need to change with time. Many "business divorce" situations evolve out of a lack of agreement and clarity in this very area.

Valuation

A buy-sell agreement can give the company or individual shareholders rights to require an ownership share sale at a particular price or pursuant to an agreed-upon formula when agreed triggering conditions are met. A considerable amount of art goes into assessing such a formula for valuing the purchase or sale, but a good agreement will also lay out dispute resolution options so the parties can be more assured against an indefinite delay or an expensive dispute. Buy-sell agreements can also be funded with key personal life insurance and

payment time frames can be set out so that the business is not fatally impacted by the exercise of a buyout.

Periodic Review

Talking about possible problems before they arise can be unpleasant. On the other hand, it is less unpleasant than undiscussed, but obvious tensions. Shareholders will have different issues, options and intentions in the beginning of a business than they will midstream. Nonetheless, an even-handed buy-sell agreement or revision of an existing shareholder agreement or operating agreement need not be an impossibly daunting task. The first step is always to understand the current agreement, if one exists. It is almost always the case that on review, each and every shareholder sees some reason to change some provision of existing agreements. This may result in some "horse trading" but often results in a new shared vision of how governance and shareholder buy-sell or exit rights should be defined.

Know where your exits are! A periodic update of your exit plan should always be on the checklist for business owners. Blue skies!