



# The Importance of Buy-Sell Agreements: Two Cases

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## LEGAL & COURT CASE UPDATE

### ***The Importance of Buy-Sell Agreements: Two Cases Spell Out What Can Go Wrong***

***Fausak's Tire Center, Inc. v. Blanchard*, 2006 Ala. Civ. App. LEXIS 719 (December 8, 2006); and *Bullet Land, Inc. v. Thal*, 2006 U.S. Dist. LEXIS 88521 (December 7, 2006)**

These two cases highlight the many problems associated with buy-sell agreements—what Z. Christopher Mercer calls “ticking time bombs” in his new release, just published this past December (see sidebar on page 17).

In the *Fausak* case, the shareholders to a small company discussed and debated their buy-sell provisions for years, but failed to put the final terms in writing—until one of them died. That would seem to be an easy problem to face and fix—but the second case, *Bullet Land*, shows that even when parties memorialize a formal appraisal procedure, what Mercer terms a “process buy-sell agreement,” disagreements among the parties and the appraisers can turn a legally viable provision into a lawsuit.

#### **Death of a shareholder**

In 2000, three brothers plus two business associates bought a company for \$1.1 million, or \$2,100 per share; the sole asset was a tire store on a piece of real property. For the next three years, they discussed the need for a buy-sell agreement, drafted at least four different versions, and purchased life insurance policies to fund a buy-sell—but failed to formalize the terms. In 2002, the shareholders modified the purchase price of the company stock to \$2,500 per share, which all agreed was fair. But it wasn't until one of the

brothers died in 2003 that the remaining shareholders executed a buy-sell agreement fixing the stock value at \$2,500 per share—and this still took them nearly a year following the shareholder's death.

At the time of his death, the shareholder owned a 20% interest in the company, which the company valued at nearly \$17,000 (the record does not clarify how this value was reached). The company also valued the decedent's 125 shares at the \$2,500 price for a total of \$312,500. Accordingly, the remaining shareholders offered the widow a total of just under \$333,000 to buy-out her husband's interest, less a \$15,000 advance they had made to his estate.

But even after cashing the \$15,000 check (which was endorsed “for advancement buy/sell agreement”) the widow apparently balked, perhaps believing that given the company's growth since her husband's death, its per-share value had risen as well.

The company tried to argue that the shareholder's agreement to modify the purchase price of the stock to \$2,500 was a “note or memorandum” sufficient to establish the terms of a buy-sell agreement at the time of the husband's death—as further evidenced by the widow's cashing of the \$15,000 advance. The probate court disagreed, however, as did the Court of Appeals on review. To satisfy the applicable Statute of Frauds, any writing must contain the “essential terms” of the alleged agreement, including, in the case of a buy-sell, the “mutual assent” of the signing parties to its purpose:

The problem with considering the stock valuation document as a memorandum...is not that the document might have been intended for some other purpose than a buy sell agreement, but, more fundamentally, that it is simply insufficient to evidence a buy-sell agreement at all.

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## The Importance of Buy-Sell Agreements

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### Even written buy-sells cause problems

The *Fausak* case shows what can happen when parties delay too long implementing a buy-sell agreement; the *Bullet Land* case illustrates what can happen when the terms aren't sufficiently spelled out, especially those concerning the binding effect of the appraisal(s) involved.

The *Bullet Land* partnership was formed to renovate and operate a historic hotel; in early 2006, the general partner received a written notice of removal, to which he consented. The partnership's buy sell agreement involved five basic steps: 1) each party selects an appraiser; 2) those two appraisers select a neutral

third appraiser; 3) the three appraisers "collectively" determine a fair market value; 4) in the event these appraisals differ, the lowest value is disregarded and the two higher values are averaged; and 5) the average is submitted to a CPA to determine the final purchase price.

All of the steps took place. The general partner and the partnership each selected an MAI appraiser, who then selected a third, neutral appraiser. The appraised values for the partnership came back at \$17.1 million, \$13.4 million, and \$12 million, respectively. The latter (from the neutral appraiser) was tossed out, and the buy-out price for the GP's interest was calculated to be \$3.6 million, based on the remaining two appraisals. An independent CPA confirmed the buy-out price—and the deal appeared ready to close, per a letter from *Bullet Land*'s counsel confirming the "agreement of the parties."

But then the neutral appraiser sent a report to *Bullet Land*'s lawyer, stating that the \$17.1 million appraisal was "not credible," as it was based on inappropriate comparable data and projections that were not "supported by market evidence and...conditions." What followed was a lawsuit in which both parties disputed the facts as well as the claims—the partnership attacking the \$17.1 million appraisal and the general partner trying to enforce the buy-out price as an arbitration agreement.

### Buy-sell is not an arbitration agreement

In the end, their only agreement was that the appraisal process had failed to bring about a purchase. Despite the near closure of the buy-sell process, the Court found it did not constitute an arbitrated settlement agreement, and denied the general partner's motion to dismiss—leaving all parties exposed to further litigation and costs.

Hindsight is perfect, of course, but just think of the effort and expense that could have been saved, had all the parties to these two cases had the benefit of Mercer's new book.

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