



Critical Event Agreement

Checklist of issues to consider

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If more than one family is involved in any business enterprise it is advisable to plan for what is to occur on the death or incapacity of the key stakeholders involved in the business. This should form part of your business succession plan.

The business could be structured in a number of ways. For example, the business may be conducted by individuals in partnership, a company in its own right, individuals or companies as trustee of one or more discretionary trusts or unit trust or a combination of these. For simplicity we shall refer to the parties who have an interest in the business as “partners” even though they may actually be shareholders in a company or unit holders in a unit trust.

Most of the time the surviving partners want to purchase the deceased partner’s share in the business so that they are not left in business with the deceased partner’s family. The family of the deceased partner also tend to want the surviving partners to purchase the deceased partner’s share so that they can receive the cash from the sale.

This common desire is usually met by the partners entering into a deed whereby:

1. The deceased partner (through their executor/personal representative) gives the surviving partners an option (called a “Call Option”) to buy the deceased partner’s share of the business, and
2. The surviving partners give the personal representative of the deceased partner an option (called a “Put Option”) to require the surviving partners to buy the share off the personal representative of the deceased partner.

It is also usual for the parties to take out life insurance so that on the death of a partner the surviving partners receive an insurance payout to help them pay for the deceased partner’s share.

This deed is commonly referred to as a “Critical Event Agreement”, “Put/Call Option Deed” or a “Buy/Sell Agreement”.

Some of the issues normally dealt with in a Critical Event Agreement are listed in this checklist. Completing the checklist will help us prepare the Critical Event Agreement that meets your particular business succession plan.

In this checklist:

1. "Business Enterprise" means the company, partnership, unit trust or other business structure that conducts the business;
2. "Equity" means the interest you hold in the Business Enterprise (be it shares in a company, a share in a partnership or units in a unit trust);
3. "Partner" means the person, company or trust that holds the Equity;
4. "Principal" means the key person behind each Partner whose life would actually be insured;
5. "Policy Owner" means the person, company or trust that may own the insurance policy and be entitled to receive the proceeds.

- ☐ Please provide details of the Business Enterprise. For example, the business may be conducted by individuals in partnership, a company in its own right, individuals or companies as trustee of one or more discretionary trusts or a unit trust etc (In time we may need to obtain copies of these and any company constitution or trust deeds).

- ☐ The full names and addresses of the persons who actually hold the Equity in the Business Venture (the Partners). Given that the business may be conducted in one or more ways it could be that the Equity may comprise an interest in a partnership, shares in a company, units in a unit trust or one or more in a combination of these. Please provide details of the person or company that owns the partnership interest, share or unit.

- ☐ The person who actually holds the Equity in the Business Venture (the Partner) may not be the key individual involved. For example, shares in a company may be held by another company rather than an individual. Please provide the full name and address of the key individual persons (the Principals) who effectively control the company or trust that in turn hold the Equity in the business. These are the persons whose life is likely to be insured.

- ☐ Consider whether you wish the trigger event for the exercise of an option to sell and buy the Equity to be just the death of a Principal or perhaps extending to the total and permanent disability (TPD) or the trauma (such as terminal illness) of the Principal.

- ☐ Consider whether you wish to include other trigger events for which there may be no insurance to fund the transfer of Equity (eg a person reaching a certain age or maybe a person choosing to work in the business only part time).

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- ☐ How is the purchase price of the Equity to be determined if a trigger event were to occur? For example, is it to be based on a formula, a pre-agreed figure that the Partners will review from time to time, market value (with or without a discount), an amount that is equivalent to the insurance payout or some other method of determining the purchase price?
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- ☐ Consider whether the method of calculating the purchase price may differ depending on the trigger event that occurs (eg death versus reaching a certain age) or even depending on the method by which a purchase price may be paid or funded (eg funded by insurance and paid immediately versus the seller providing finance to the buyer to be repaid over time).
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- ☐ Do we need to consider whether or not any of the Partners or the Principals will have lent money to the Business Enterprise so that on completion of the sale of the Equity following the death of a Principal, the loan also needs to be repaid?
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- ☐ Are there likely to be guarantees provided by the deceased Partner/Principal to external creditors of the Business Enterprise such that those guarantees will need to be released on completion of the sale?
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- ☐ What level of insurance is required bearing in mind you should attempt to at least ensure the level of insurance is sufficient to cover:-
1. The anticipated purchase price and
 2. The repayment of any loan made by a Partner to the Business Enterprise and
 3. Possibly the repayment of all or part of the debt to external financiers or other creditors so that the estate of the deceased Partner/Principal can be assured that it will be released from any guarantee?
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- ☐ How often do the Partners agree they will review the level of insurance cover?

- ☐ Who is to pay the premiums on the insurance policy? Bear in mind that the premiums are unlikely to be tax deductible if you want the proceeds on a payout to be tax free.

Example

- Does each Principal pay the premiums on that Principal's insurance policy? Will a Principal pay the premiums on the insurance policy of the other Principal? Will the Business Venture pay the premiums? (Beware of the effects of a company owning the policies and paying the premiums which you should discuss with your accountant or financial advisor).

- ☐ Who will own the policies and how are the proceeds to be dealt with?

We will probably need to walk through this with you because the preference can be for each Partner/Principal to insure themselves and for the proceeds to be deemed receipt of the sale price of the Equity.

The proceeds can also be deemed to be payment by the continuing Partner/Principals for the assignment of a debt owed to the deceased Partner/Principal by the Business Equity.

We may also need to consider if we want the estate of a deceased Partner/Principal to be obliged to give part of the proceeds to the continuing Partner/Principals so that they can in turn lend the proceeds to the Business Enterprise to enable the Business Enterprise retire debt owed by the Business Enterprise to a bank.

Asset protection issues can also play a role in who should receive the proceeds of a policy (We suggest you discuss this issue of policy ownership with us).

- ☐ If there are surplus insurance proceeds available after the above payments are made then to whom should they be paid?the estate of a deceased Principal for the benefit of his/her family or to the continuing Partners to assist with the transition of the business from the loss of the Partner/Principal or a combination of the two?

- ☐ What if there is a shortfall in the proceeds from the insurance? Does this negate the whole agreement, or does the agreement still apply but is the balance of the purchase price and Partner loan payable to be funded by the continuing Partners in any manner they can, or is it to be paid over time with or without interest and with or without security?

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- ☐ If insurance is not available to fund any or all of the anticipated purchase price, the Partner's loan and the guaranteed financier amount (because the premiums are too expensive or one or more of the Principals are un-insurable) how is the purchase price to be paid and the loan dealt with?

Examples

- Is it payable in a lump sum at completion or is it to be paid by a series of instalments over a fixed time – eg 60 calendar monthly instalments?
 - Is it to be paid by instalments over time of a fixed amount – eg monthly instalments of \$5,000 until it is fully paid?
 - If the purchase price is not all paid at completion, is interest payable and if so what rate of interest is to apply?
 - If the purchase price is not all payable at completion, is security to be provided and if so who is to pay for the costs of this security?
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- ☐ What period of time is to be allowed for the exercise of the option? It should not be earlier than a reasonable period of time after the option event has occurred and the insurance company has acknowledged and agreed to pay the insurance claim.
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- ☐ What period of time is to be allowed between the exercise of the option and the completion of the sale?
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- ☐ Do we need to consider whether the death or total and permanent disability or trauma of one of the Principals (or any other trigger event) is to only entitle some of the other Partners to purchase the Equity? For example, if there are two husband and wife couples involved in a partnership does the death of one spouse only give right to the surviving spouse to purchase that person's Equity or do all the surviving Partners have a right to purchase the Equity pro rata?
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- ☐ If you have an insurance broker, please provide their name and contact details.
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- ☐ If you have an accountant, please provide their name and contact details.

- ☐ If you have a financial planner, please provide their name and contact details.

- ☐ If you have a preferred insurance company that you deal with please provide the name of the company.

- ☐ Do any Principals need to review their own estate planning needs – such as a review of their Wills and enduring powers of attorney? If a Critical Event Agreement is entered into then it is prudent to insert a clause in the Will referring to it to ensure the executor learns of its existence and exercises the put option.

- ☐ Are there other issues that you should raise with us?

For further information please contact us.

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