

**CROSS-PURCHASE AGREEMENT BETWEEN TWO PARTNERS:
SURVIVOR AGREES TO PURCHASE INTEREST
OF DECEASED PARTNER**

FORM NO. 3

Unless agreed to the contrary, a partnership dissolves at the death of any partner. A business continuation agreement permits the business to continue.

This form should be used only when there are two partners in a partnership. Upon the death of a partner, the agreement requires the survivor to purchase, and decedent's estate to sell, decedent's interest.

It is contemplated that each partner will apply for and own a policy of insurance on the life of the other partner. Each partner will name himself as beneficiary and pay all premiums on the policy he owns.

When one partner dies, the survivor will receive the insurance proceeds and, in return for the decedent's partnership interest, use them to purchase the decedent's interest in the partnership.

Generally, each partner will individually pay the premium on the policy he owns. Since this policy insures his partner, the premium borne by each partner is a function of his partner's age, sex, health, and the value of the partner's partnership interest. If, for example, one's partner is young, healthy, and owns a small interest in the partnership, the premium on the policy insuring this partner is small. This is logical because, actuarially, the purchasing partner will have a long time to accumulate a relatively small amount of money.

On the other hand, if the partner is old, unhealthy, and owns a large per-centage of the partnership, the premium on the policy insuring his life will be relatively large. Again, it is logical that a prospective purchaser of such a partner's partnership interest pay a larger premium. This is because the purchaser has a rela-tively short time to accumulate a relatively large amount of money.

If the partnership has more than two partners, a cross-purchase agreement becomes more complicated. One complication is attributable to the fact that each partner must own a policy on the life of each of his partners. The total number of policies needed to fund the arrangement is equal to $n(n-1)$, where n = the number of partners. At a certain point, it is no longer administratively feasible to maintain a cross-purchase arrangement.

The other complication is attributable to the fact that after one partner dies, more than one partner will survive. This means that there is an ongoing need for the buy-sell agreement. Furthermore, since the value of each surviving partner's interest will have increased, the buy-sell agreement will then be underfunded. As a result, the survivors will want to purchase the policies owned by the decedent from the personal representative of his estate. If there are a large number of survivors, this task can be an administratively difficult.

Therefore, in a multipartner situation, the partnership, as an entity, usually agrees to purchase a deceased partner's partnership interest. An entity purchase arrangement will eliminate the need for multiple policies. In addition, it won't be necessary to transfer ownership of the policies after a partner dies. The policies will continue to be owned by the partnership.

Please note: this agreement is for review only, and should not be used without guidance of legal counsel as there are significant tax + legal implications upon use.

**AGREEMENT BETWEEN TWO PARTNERS
TO PURCHASE PARTNERSHIP INTEREST OF DECEASED PARTNER
(CROSS-PURCHASE AGREEMENT)**

— For the Use of Legal Counsel Only —

FORM NO. 3

This is an Agreement between [Names of Partners] (the “Partners”, or individually, the “Partner”). Today’s date is _____, 20 ____.

BACKGROUND INFORMATION

- A. The Partners are all of the partners of [Name of Partnership] (the “Partnership”), a partnership organized under the laws of [Name of State].
- B. The Partnership is now engaged in the business of [Description of Nature of Business], and is trading under the name of [Trade Name, if any].
- C. Each Partner owns an interest in the Partnership in accordance with the table below.

	<u>Partner Percentage Interest</u>
	%
	%

- D. The Partners believe that it is in their best interests if a deceased Partner’s interest in the Partnership is purchased by the surviving Partner.
- E. The Partners want to avoid liquidation of the Partnership business upon the death of a Partner.
- F. The Partners entered into a partnership agreement with respect to their rights and duties as partners (the “Partnership Agreement”) on [Date of Partnership Agreement].

Therefore, the Partners agree as follows:

- 1. General Restriction.** Neither Partner shall transfer, assign, pledge, sell or convey any interest in the Partnership, now owned or later acquired by him, except in accordance with this Agreement.

- 2. Disposition of Partnership Interest During Lifetime.** Neither Partner shall transfer, sell, assign, or convey his interest in the Partnership during his lifetime to any third party without first providing written notice of such intended transaction to the other Partner, including the identity of the proposed transferee and the price and terms upon which the transferor Partner proposes to transfer such Partnership interest. Within thirty (30) days following the receipt of such notice, the other Partner shall have an option to purchase the entire Partnership interest of the transferor Partner for a price equal to the lesser of: (a) the price disclosed in such notice, or (b) the price set forth in paragraph 5 of this Agreement. If the Partner elects to exercise his option, the payment of the purchase price shall be upon either (a) the terms set forth in such notice or, (b) the terms provided in paragraph 5 of this Agreement, at the option of the purchaser. If the Partner does not elect to exercise its option within thirty (30) days following the receipt of such notice, then the transferor Partner may transfer ownership of his Partnership interest in strict accordance with the notice given to the other Partner, free of the restrictions imposed by this Agreement; provided that the Purchaser of such Partnership Interest shall take it subject to the terms and restrictions imposed hereby and shall become a party hereto.

Comment:

Some restriction on inter vivos sale is necessary if the agreement is to “peg” the value of the partnership interest for federal estate tax purposes. Unlike corporate stock, partnership interests are not ordinarily transferable unless the partners agree to the contrary. If partnerships are transferable in your state, restrictions on transfer will probably be found in the Partnership Agreement. If the restriction therein is adequate, the above provision should be omitted.

Before drafting any restriction or option, however, several points should be considered. To “peg” the value of a deceased partner’s partnership interest for federal estate tax purposes, a partner who wants to transfer his partnership interest while he is alive must first offer it for sale at a price equal to or less than the price at which the partnership interest will be sold at death. Such an option should not be used unwittingly. While an option meeting this requirement might “peg” the value of the business interest for estate tax purposes, it will also restrict the right of a partner to extract the maximum price for his partnership interest while he is alive. The parties should decide whether estate tax certainty or the ability to extract the maximum price for a partnership interest is more important.

3. Disposition of Partnership Interest Upon Death of a Partner.

- (a) At the death of a Partner, the surviving Partner shall purchase, and the personal representative of the deceased Partner’s estate shall sell, the deceased Partner’s entire interest in the Partnership.
- (b) The Partnership Interest of a deceased Partner purchased and sold under this paragraph shall be purchased and sold at the price and upon terms set forth in paragraph 5. below.
- (c) The closing of such purchase and sale shall take place as soon as practicable after the decedent’s death, but in no event later than six (6) months after the decedent’s death.

4. Disability of a Partner. If a Partner becomes “totally disabled”, the following provisions shall apply to the disposition of his interest in the Partnership.

- (a) **Definition.** The term “total disability” or “totally disabled” means the inability of a Partner to perform substantially all the regular duties of his position with the Partnership due to sickness or injury. In addition, a Partner shall be conclusively deemed to be totally disabled if he is determined eligible to receive disability benefits from (i) any policy of disability insurance issued by a commercial insurer, (ii) a waiver of premium benefit forming a part of any policy of life insurance, or (iii) Social Security. If there is a dispute regarding the existence or continuation of a total disability, the non-disabled Partner may require the purportedly disabled Partner to submit to an examination by a medical doctor licensed to practice medicine at such reasonable times as it may require but not more frequently than once in any 120 day period. The non-disabled Partner shall pay for such examinations if the purportedly disabled Partner is found to be actually disabled. If the purportedly disabled Partner is found not to be disabled, then the purportedly disabled Partner shall pay for such examinations. Any period of total disability shall be deemed to be continuing until the disabled person has either died or failed to meet the definition set forth above for a period of three consecutive months.
- (b) **Obligation to Purchase Partnership Interest.** After a Partner has been totally disabled for a continuous period of 18 months, the non-disabled Partner shall purchase, and the disabled Partner shall sell, the entire partnership interest owned by the disabled Partner, upon the price and terms set forth in paragraph 5 of this Agreement.

Comment:

The above provision should apply, if at all, only to partners who regularly provide necessary services to the partnership. It should not apply to passive investors.

If disability insurance is to be used to fund the buyout, the insurer’s determination of disability under the policy should be used to define “disability” for purposes of the Agreement.

The above agreement requires the non-disabled partner to purchase a disabled partner's partnership interest. In some cases, the parties might want to give the non-disabled partner an option to purchase the disabled partner's partnership interest.

The above buyout is triggered after a partner has been continuously disabled for eighteen months. Although this is typical, any period agreeable to the parties can be used. If disability insurance is to be used to fund the buyout, the buyout should be triggered upon the occurrence of the "Triggering Event".

The "Triggering Event" shall be the Insurer's determination that the insured is totally disabled, that the Beginning Date has been reached, and that there are no remaining conditions to payment on the policy other than actually incurring the buyout expense.

If the disability buyout is insured, the prospective purchaser should be obligated to purchase the disabled partner's business interest, because such insurance is an indemnity contract.

5. Price and Terms for Purchase and Sale of Shares.

- (a) **Price.** Unless later modified according to this Agreement, and except as expressly provided otherwise, the price to be paid upon the purchase and sale of a Partner's interest in the Partnership pursuant to the provisions of this Agreement shall be the product of: (i) [Total Value Of Partnership], and (ii) the selling Partner's percentage interest in the Partnership as of the date giving rise to the purchase and sale hereunder.

Comment:

The above provision values the Partnership at a fixed price. In some cases, the partners might want to have the value of their interests determined by an appraisal. If this approach is to be used, the draftsman should address how the appraiser(s) will be selected, the necessary qualifications of such appraiser(s), the standard to be used by the appraiser(s) to determine value (e.g., value which a willing buyer would pay a willing seller, neither being under compulsion to buy or sell?), whether valuation discounts should be applied (e.g., minority discount, lack of marketability), and who will pay appraisal fees.

As an alternative to a fixed price or a price determined in accordance with an appraisal, a multiple of "book value" is sometimes appropriate to determine the purchase price. A sample clause is shown below.

- (a) **Price.** Unless modified according to this Agreement, and except as is otherwise provided, the price to be paid upon the purchase and sale of a Partner's Partnership Interest will be the product of: (i) _____% [Note: Insert appropriate multiple expressed as a percentage.] of the "Book Value" (as defined below) of the Partnership determined from the regularly prepared financial statement of the Partnership as of the fiscal year end of the Partnership last occurring before the event giving rise to the purchase and sale hereunder, and (ii) the selling Partner's percentage interest in the Partnership as of the date giving rise to the purchase and sale hereunder. The "Book Value" of the Partnership shall be difference between the assets and the liabilities of the Partnership as shown on such financial statement.
- (b) **Modification of Price.** The price to be paid for a Partner's Interest in the Partnership as set forth in subparagraph (a) may be modified by the execution of an amendment, signed by all the then living parties to this Agreement, setting forth a new price or a specific method of determining the price. Such amendment shall supersede subparagraph (a) and any other amendments.
- (c) **Terms.** The purchase price to be paid for any purchase and sale of a Partner's Interest in the Partnership pursuant to this Agreement shall, unless expressly provided otherwise, be paid by the purchaser to the seller in cash or certified check at closing.

Comment:

The above provision requires the purchaser to pay the entire purchase price in cash at the closing. In some cases, it is appropriate for the purchase price to be paid in cash to the extent that insurance proceeds are received on account of the insured's death and the balance of the purchase price to be financed by the seller. A sample clause permitting the purchaser to pay some of the purchase price in installments is found below.

(c) Terms. The purchase price to be paid for any purchase and sale of a Partner's Interest in the Partnership, except as expressly provided otherwise, shall be paid by the purchasing party at closing of the purchase and sale as follows:

(i) The purchasing party shall deliver to the seller an amount of cash at closing equal to the greater of _____% of the total purchase price, or the amount of life insurance proceeds received by the purchasing party on account of the death of a Partner (if the purchase and sale is made pursuant to the death of a Partner), but not more than the total amount of the purchase price.

(ii) Any balance of the purchase price not paid in cash at closing shall be represented by a negotiable promissory note (the "Note") in the original principal amount of the balance. The Note shall require payment of the principal amount in _____ equal consecutive quarterly installments together with interest at a rate per annum equal to the minimum rate necessary to avoid additional interest being imputed to this transaction for federal income tax purposes. The Note shall allow the prepayment of all or any part of the principal amount at any time without penalty.

Comment:

The above-referenced note would be unsecured. If the parties want a secured note, appropriate changes should be made to describe the nature and extent of the collateral.

(d) Liens. The selling party shall transfer and convey the interest in the Partnership to the purchasing party at closing free and clear of all encumbrances except those, if any, arising out of this Agreement.

(e) Death Following Sale of Partnership Interest. If a living Partner sells his interest in the Partnership pursuant to this Agreement, and if such selling Partner dies before receiving the entire purchase price, then the purchasing party shall pay to the estate of such Partner an amount equal to the lesser of: (i) the amount of life insurance proceeds received by the purchasing party on account of the death of such Partner, or (ii) the remaining principal amount owed by the purchasing party to the Partner as a result of the purchase of said interest in the Partnership. Such payment shall be credited as a principal prepayment of any note given by the purchasing party pursuant to this paragraph. To the extent of any remaining principal balance, such note shall continue in effect according to its terms.

Comment:

The above provision should only be used when seller financing is contemplated.

6. Insurance Policies.

(a) The parties to this Agreement shall purchase and maintain policies of insurance on the lives of each other to provide for their obligations under this Agreement. Neither Partner shall possess any incidents of ownership in any such policy insuring his life. The policies will be the sole property of the owner. Neither Partner nor any successor, transferee, assignee, or personal representative of either Partner shall have any collateral interest in any such policy insuring his own life.

(b) If the Partnership Interest of either Partner is transferred pursuant to this Agreement, either at death or during life, and if all the obligations for payment of the purchase price for such interest in the Partnership have been fully satisfied, then any living Partner shall be entitled to purchase from the other Partner or the Partner's estate any policy of insurance owned by the other Partner insuring his life for a price equal to the interpolated terminal reserve of the policy, plus any unearned premiums, less any policy indebtedness.

7. Specific Performance. Interests in the Partnership cannot be readily purchased or sold on the open market and for that reason, among others, the parties will be irreparably damaged if this Agreement is not specifically enforced. If any dispute arises concerning the sale or disposition of an interest in the Partnership pursuant to this Agreement, an injunction may be issued restraining any sale or disposition pending the determination of such controversy upon application to a court of competent jurisdiction by any party to this Agreement. If any controversy arises concerning the purchase or sale of such interest in the Partnership, the same shall be enforceable in a court of equity by decree of specific performance. Such remedy shall, however, be cumulative and not exclusive, and shall be in addition to any other remedy which the parties may have.

8. Right of Survivor to Continue Business. It is the intent and purpose of this Agreement to permit a Partner who purchases the other Partner's Interest in the Partnership to, subject to payment of the purchase price as herein provided, continue the Partnership business as his own. Such purchasing Partner shall be under no duty to account to the deceased Partner's heirs or personal representative. He shall be free to conduct the Partnership business under the same name and at the same address, he shall assume all Partnership obligations and shall indemnify and save harmless the selling Partner and his successors in interest from such obligations.

9. Termination of Agreement. This Agreement shall terminate upon the first to occur of the following events:

- (a) The execution of an agreement to revoke this Agreement, signed by all the living Partners and the personal representative of any deceased Partner who has not yet been fully paid for the sale of the deceased Partner's interest in the Partnership; or
- (b) The bankruptcy, receivership, or dissolution of the Partnership (but such shall not extinguish the rights of obligations of the parties hereunder arising out of any event occurring before such event); or
- (c) The deaths of both Partners within 90 days of each other.

10. Amendment. This Agreement is the entire understanding among the parties and may be altered, amended or revoked only by subsequent written instrument executed by all the living parties.

11. Persons Bound. This Agreement is binding upon the Partners, their heirs, legal representatives, transferees, successors and assigns, and each Partner shall execute a Will directing his executor to perform this Agreement and to execute all documents necessary to effectuate the purposes of this Agreement, but the failure to execute such Will shall not affect the rights of the Partners or the obligations of any estate.

12. Benefit. This Agreement is for the benefit of the parties, their heirs, executors, administrators, successors, assigns and transferees.

13. Notices. Each Partner shall give prompt notice to the other Partner of all offers, acceptances, refusals, and exercise of options made pursuant to this Agreement. All notices, writings, offers, acceptances, refusals, payments, or agreements given or required to be given under this Agreement shall be made in writing and sent by registered or certified mail, return receipt requested, to the last known address of each Partner as such appears on the books of the Partnership. Any such notice or other writing shall be deemed given and received upon the expiration of three days following such mailing with proper postage affixed.

14. Execution of Other Documents. The parties agree to execute and deliver all authorizations, documents and instruments which are necessary to carry out the terms and conditions of this Agreement.

15. [Name of State] Law. This Agreement is being delivered and is intended to be performed in [Name of State] and shall be construed and enforced in accordance with the laws of [Name of State].

16. Heading. Any headings are inserted solely for the convenience of reference, and are not a part of this Agreement nor shall they affect its meaning, construction or effect.

17. Prior Agreement. This Agreement revokes all previous agreements among the parties to the extent they are inconsistent herewith, including the Partnership Agreement.

IN WITNESS WHEREOF, the parties have hereunto set their hands and seals, the day and year first above written.

Witness Partner

Witness Partner
