Planning for Changes in the Ownership of your Restaurant

by Kelly Caralis, Esq.

Every closely held restaurant with two or more partners should anticipate and plan for events that could alter the ownership of the restaurant, such as the departure, death, disability, bankruptcy, or divorce of one of the partners. One common way to do this is by implementing buy-sell provisions in the restaurant's operating agreement if the restaurant is a limited liability company, or in a separate shareholder agreement if the restaurant is a corporation. Simply put, buy-sell provisions set forth the rights and obligations of the partners to buy the shares of another partner when certain events occur. Most partners overlook these types of provisions when forming their restaurant business because they find them uncomfortable to talk about and plan for, especially in the early stages of a business relationship. However, entering into buy-sell provisions at the beginning of your business relationship can save you both money and angst in the long term. It may help to think of buy-sell provisions as a sort of "premarital agreement" between you and your partners setting forth the orderly terms of your "separation" before any hard feelings toward each other start to surface. That being said, if you and your partners did not contemplate buy-sell provisions during the "premarital" stage of your business relationship, you should consider them before you need them.

Below are some basic questions and answers for you to review and discuss with your partners as you consider the topic of buy-sell provisions:

1. **What types of events will trigger a buy-sell?** Events that commonly trigger a buy-sell include when (i) a partner who also works for the restaurant retires, voluntarily resigns or is terminated for cause, or (ii) a partner dies or is unable to continue his or her duties due to disability, or (iii) a partner declares bankruptcy or gets divorced and his or her ex-spouse stands to receive an partnership interest in the restaurant, or (iv) a partner wants to sell his or her share of the restaurant to an outside third party. You can include all or any of these events in your buy-sell provisions.
2. **Should the buy-sell be mandatory or optional?** After deciding which trigger events to include in your buy-sell provisions, partners will need to then decide which events result in a mandatory purchase or an optional purchase at the election of the remaining partners. For example, if the death of a partner triggers a buy-sell right in the other partners and the partners or the restaurant have purchased life insurance policies on the

life of the deceased partner, then the purchase of the deceased partner's share would likely be mandatory upon the death of the partner. Alternatively, if there is no life insurance on the deceased partner's life, the partners may decide to make the purchase optional at the election of the remaining partners.

3. **Who can purchase a partner's share of the restaurant once a buy-sell event has been triggered?** This is typically limited to the restaurant entity itself (typically called a redemption) or its remaining partners in the event of a buy-sell triggered by death, disability, termination of employment or an involuntary transfer, but may allow a partner to sell to an outside third party (typically called a voluntary life-time transfer) after an offer to purchase has been first made to the remaining partners and is rejected. For example, in the event a partner wants to sell his or her share of the restaurant to a third party during his or her lifetime, buy-sell provisions can be drafted to indicate that the partner must first obtain a bona-fide offer from the third party to purchase the share and then give the remaining partners the option to purchase the share of the restaurant for the same price and on the same terms as in the offer before the partner can sell his or her share of the restaurant to the third party.

4. **What price will be paid for a partner's share of the restaurant upon a buy-sell?** It is important to establish how the purchase price will be determined at the time of the trigger event. While there are several methods that can be used to determine the purchase price of a partner's share, the most typical methods are either a formula method or an appraisal method. In both of these methods the partners agree on the process for determining the purchase price now, which is then only computed at the time of a trigger event. Using the formula method, the partners agree on a predetermined formula applicable to their specific industry to compute the fair market value of the business at the time of the trigger event. Using the appraisal method, the partners agree on a process for the selection of an appraiser with industry specific knowledge and experience to be selected at the time of the trigger event, who will then determine the fair market value of the restaurant business. As noted above, in the case of a voluntary life-time transfer, the purchase price is typically the purchase price set forth in the bona-fide third party offer received by the departing partner.

5. **What terms are applicable to the sale?** Terms and conditions applicable to the sale typically include payment terms, closing deliverables and the closing date. You will want to make sure that you agree on the payment terms which may include a lump sum payment at closing, delivery of a promissory note at closing, or some combination of the two. Payment terms are generally discussed at length between partners when implementing buy-sell provisions because a partner will likely want to receive (or want his or her spouse to receive) payment of the full purchase price at the closing in one lump-sum while, from the restaurant's standpoint, it may not want to subject itself to a large lump-sum payment for cash flow reasons. If payment is made by delivery of a promissory note, the term, interest rate and any security for the note should be addressed in the buy-sell provisions.

Each partner will inevitably have his or her own views on the subject and way of approaching it, and the approaches may vary based on the type of trigger event or the partner affected by it. In any event, if you do not already have buy-sell provisions in place you should be prepared to spend some time discussing this topic, and the various options and alternatives available to you, with your partners and your attorney and decide on a plan of action before changes in the ownership of your restaurant occur.

Lastly, it is worth mentioning that in restaurants with two equal partners (i.e., 50/50 ownership), buy-sell provisions (commonly called "shotgun" provisions in this context) can also be an effective way to deal with deadlock situations where the two partners cannot agree on decisions related to the operations, growth or future of the restaurant. A discussion of these types of shotgun provisions is beyond the scope of this article, but if you own a restaurant with one other 50/50 partner you should consider and discuss this type of provision as well.

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