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Buy and Sell Deeds and the application of insurance proceeds

While the health implications arising from the Covid-19 pandemic have been top of everyone's mind in North Canterbury, many small to medium sized businesses often find it challenging in dealing with the death, critical illness or total permanent disability of a key director who is also a shareholder in an enterprise.

An often overlooked but important solution for this problem is for policies of insurance to be taken out in respect of a key director-shareholder.

This insurance generally includes term life / terminal illness insurance, total permanent disability insurance and/or critical illness insurance which on the occurring of such an event, the proceeds of such policies are used by the surviving (or unaffected) director-shareholder to purchase the shares.

The reasoning behind this structure is to allow the remaining director-shareholder to continue with the business on an unfettered basis without then having to deal with the deceased estate or trustees (in the case of a trust) which may impede business continuity.

The value of the shares for sale should be determined (often by the accountant of the company in conjunction with the shareholders agreement). This ought to be calculated each year and recorded in the company minute book.

On the occurring of an insured event happening to a director, a claim will then be lodged under the policies of insurance and the claim proceeds utilised for the purchase of the shares.

If the claim proceeds of the policy of insurance are greater than the purchase price, any surplus proceeds may be equally divided amongst the remaining shareholders.

In some instances, the claim proceeds may be less than the purchase price and the parties may determine that the balance of the purchase price which is outstanding shall bear interest and may be payable in equal instalments over a period of years (which may be determined by the parties in advance).

In circumstances where a critical illness occurs as an insured event, the management of the claim proceeds may be slightly more complicated. The settlement date in terms of



the execution of the transfer of shares will be suspended pending what is known as a "wait period".

This mechanism is designed to establish whether the director to whom the insured event has occurred, is able to return to work.

If at the expiry of the "wait period" the director affected, is unable to resume his position as a director (often certified by an occupational therapist) and/or perform and undertake the roles and responsibilities required of his office, the parties will proceed with the transfer.

If however during or by the expiry of the "wait period" the director resumes his posi-

tion as a director and continues to perform the roles and responsibilities required of him, the claim proceeds will continue to be held for the benefit of all parties.

It is important from time to time for the policies of insurance to be reviewed to ensure they meet the then current business requirements. The Insurance Buy and Sell Deed should in all aspects, dovetail with the Shareholders Agreement entered into by the parties so as to avoid any conflict.

If carefully crafted, it may be a very useful tool to ensure the continued smooth operation of the business whilst avoiding potentially distracting shareholder issues.

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