



Purposes and Types of Buy-Sell Agreements

By Gianfranco A. Pietrafesa

Editor's Note: This is the first in a series of articles on buy-sell agreements by members of the firm's business law group.

Every business with two or more owners should have a buy-sell agreement. A buy-sell agreement is an agreement made in advance between the owners of the business or between the owners and the business entity. It deals with the transfer, valuation and purchase of an ownership interest in a business upon the occurrence of certain events, such as the death, disability, retirement, divorce or termination of employment of an owner.

A buy-sell agreement has been described as a "premarital agreement" between business owners. It applies to all types of business entities, including corporations, limited liability companies and partnerships, and may be a stand-alone agreement or incorporated into other agreements, such as a shareholders' agreement, LLC operating agreement or partnership agreement.

A buy-sell agreement restricts the transfer of ownership interests. For example, a business owner cannot transfer his or her ownership interest except in accordance with the buy-sell agreement. One reason for such a restriction is because the owners entering into business with one another do not want an ownership interest to be transferred to an undesired person. For example, in the case of death of an owner, the surviving owners may not want to be in business with the spouse of a deceased owner.

There are three basic types of buy-

sell agreements. The first is a cross-purchase agreement where the owners agree to purchase the equity interest of a deceased or withdrawing owner. It is important to note that the owners, not the business entity, have the obligation to purchase the equity. In the event of death, the funding can be provided by life insurance. Otherwise, the payments are made over time.

It is also important to consider that a cross-purchase agreement may not be appropriate where there are numer-

ous owners. For example, if there are four owners, each must purchase a life insurance policy on the other three owners; therefore, there would be a need to purchase a total of twelve insurance policies. However, there are ways to address such a situation if a cross-purchase agreement is the best type of buy-sell agreement. For example, the owners can use a trust, which would be the owner and beneficiary of

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Contract Arbitration Clauses May Need Review

By Jason T. Shafron

Clients with arbitration clauses in their contracts should be aware of a recent U.S. Supreme Court case and the need to review and revise their arbitration clauses.

Last year, the U.S. Supreme Court issued its decision in *Hall Street Associates, L.L.C. v. Mattel, Inc.*, 128 S.Ct. 1396 (2008). The decision holds that parties cannot contractually agree to expand the standards of review of an arbitration award under the Federal Arbitration Act ("FAA"). Instead, where an arbitration award is governed by the FAA, it can be vacated, modified or corrected only for the limited reasons identified in the federal statute.

Under the FAA, arbitration awards may be vacated "(1) where the award

was procured by corruption, fraud, or undue means; (2) where there was evident partiality or corruption in the arbitrators, or either of them; (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made." 9 U.S.C. §10. Arbitration awards may be modi-

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Certifications Expand Potential Business Opportunities

By Cynthia Brooks

The new economy demands that businesses consider re-positioning themselves to succeed. Some businesses may have untapped markets on which they can capitalize by obtaining certifications as small, disadvantaged, minority, woman or veteran-owned businesses. Since the government is a large contractor of such vendors, and the recent passage of the economic stimulus packages includes many opportunities to do business with the government, now is a good time to determine if your business qualifies for any of the certifications. There are a variety of such certifications offered by federal, state and local governments. Certified businesses are also often candidates for favorable financing programs.

The Small Business Administration ("SBA") defines a small business enterprise ("SBE") as (i) a for-profit concern that (ii) has a place of business in the U.S., (iii) operates primarily within the U.S. or makes a significant contribution to the U.S. economy through payment of taxes or use of American products, materials or labor, (iv) is independently owned and operated, (v) is not nationally dominant in its field, and (vi) meets the SBA size standards. In determining what constitutes a small business, the size standards vary by industry.

Any business whose management and daily operations are controlled by one or more minorities or women, and which is at least 51% owned by one or more minorities or women, is eligible for certification as a minority or woman owned business ("M/WBE"). Qualified applicants must complete an M/WBE Certification Application and submit the application with a non-refundable application fee to the New Jersey Commerce Commission.

The Disadvantaged Business Enterprise ("DBE") certification is a federal program managed in New Jersey by the Department of Transportation ("USDOT"). The DBE certification is

for socially and economically disadvantaged business owners without regard to race or gender. The business must be at least 51% owned by one or more "socially and economically disadvantaged" individuals. Socially and economically disadvantaged individuals are citizens, or lawfully admitted permanent residents of the U.S., who are members of one of the following groups: African-American, Latin-American, Native American, Asian-Pacific American, Subcontinent Asian American, women or any other individual found to be socially and economically disadvantaged on a case-by case basis by a certifying agency according to USDOT regulations. If a firm meets the criteria, it will be automatically entered into the DBE directory for all DOT grantees in New Jersey to utilize in locating certified DBE firms. Placement in the DBE directory allows businesses to receive notices of bid advertisements free of charge. It is also a valuable tool for prime contractors and consultants seeking to achieve their subcontracting goals. DBE applicants are first subject to the applicable small business size standards of the SBA.

Veteran-owned business enterprises ("VBE's") registered in the federal government's contracting database are rapidly increasing. Each SBA district office has a veterans' affairs officer and the SBA partners with other agencies on veteran self-employment initiatives and urges companies to work with vets. The SBA recently launched a new Patriot Express loan initiative for the military community, which is intended for veterans who want to establish or expand small businesses. Also eligible are their spouses, and the spouses of service members or vets who died during service or of a service-connected disability.

For more information on these matters, please contact Cynthia Brooks.

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one life insurance policy on each owner.

The second type of buy-sell agreement is a redemption agreement where the business entity agrees to purchase the equity interest of a deceased or withdrawing owner. With a redemption agreement, the entity, not the owners, has the obligation to purchase the equity. Again, in the event of death, the funding can be provided by life insurance, in which case the entity is the owner and beneficiary of the life insurance policies. Otherwise, the payments are made over time by the entity.

A third type of buy-sell agreement is the hybrid agreement, which is a mix of the cross-purchase and redemption agreements. It generally provides the business entity with the first right to purchase the ownership interest of the deceased or disabled owner. If the entity does not exercise its option, the hybrid agreement provides the other owners with the right to purchase the ownership interest on a pro rata basis.

Prudent business owners will desire buy-sell agreements governing the transfer, valuation and purchase of ownership interests in a business upon the occurrence of certain events. Such agreements have proven to provide for the efficient and economical transfer of ownership interests, which benefit the deceased or withdrawing owner, the surviving or remaining owners and the business entity itself.

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Future articles in this series will cover such matters as the types of events triggering buy-sell obligations, the valuation of equity ownership interests, general tax issues, and dispute resolution among business owners.

For more information on buy-sell agreements, please contact a member of the firm's Business Law Group or the attorney that you normally consult with at the firm.

The Business Law Group:
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News from Herten Burstein

- **Terry Paul Bottinelli** received an invitation to speak at the Association of Trial Lawyers of America Boardwalk Seminar on the topic of “Alchemy: Turning Soft Tissue Into the Million Dollar Verdict”.
- **David Polizzotto**, the firm’s Director of Operations, recently received recognition from the Association of Legal Administrators on his 15th anniversary as a member.
- **Daniel Y. Gielchinsky** has been selected as a 2009 Rising Star by New Jersey Super Lawyers.
- **Jason T. Shafron** was promoted from Counsel to Member of the Firm, effective January 1, 2009.
- On January 12, 2009, in a case involving claims of misappropriation and fraud, **Michael I. Lubin** obtained a judgment for one of our clients in the amount of \$795,000. This judgment, including components of compensatory damages, punitive damages and attorneys’ fees, was rendered following eight days of trial over a lengthy period of time.
- On February 12, 2009, **Gianfranco A. Pietrafesa** made a presentation to the Hudson-Bergen Inn of Transactional Counsel on the topic of valuation methods used to determine the purchase price of shares of stock under buy-sell agreements.
- **Cynthia Brooks** was recently elected as Vice Chair of the Board of Trustees for Calvary Baptist Church of Morristown, New Jersey. Ms. Brooks has served on the Board for four years, which facilitates the management and daily operation of the church of approximately 2,000 members.
- Associate attorney **Daniel C. Ritson** guided his team to a third place finish in the 2008-2009 Saul Lefkowitz Moot Court Competition, Eastern Regional, which took place on February 7, 2009. The competition is sponsored by the International Trade-

mark Association and featured sixteen teams from notable east coast law schools. Mr. Ritson’s team of three third-year students from Seton Hall School of Law placed third based on two rounds of argument and a pre-competition brief. Mr. Ritson’s teams have a history of success at the competition, as his prior team won the Eastern Regional and was one of four teams to argue at the national competition in Washington, D.C. in 2008. Mr. Ritson has served as a coach for Seton Hall’s Interscholastic Moot Court Board for five years.

- The firm’s attorneys played a sig-

nificant role in this year’s Bergen County Mock Trial Competition. The Mock Trial Competition is held every year for various high schools throughout the country. **Andrew Cevasco, Terry Bottinelli, Steven Harz, Jason Shafron, David Steinberg, Patrick Ascolese, Michael Olszak and Daniel Gielchinsky** all served as judges during various stage of the competition. Dan also served as the Competition’s Assistant Coordinator. **Steven Harz** judged with his wife, **The Honorable Rachele Harz**, Judge of the Superior Court.

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fied or corrected “(a) [w]here there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award[,] (b) [w]here the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted[, and] (c) [w]here the award is imperfect in matter of form not affecting the merits of the controversy.” 9 U.S.C. §11. These narrow reasons focus more on defects in the arbitration process rather than the merits of the award itself.

The *Hall Street* decision, however, also provided that “[t]he FAA is not the only way into court for parties wanting review of arbitration awards: they may contemplate enforcement under state statutory or common law, for example, where judicial review of different scope is arguable.” 128 S. Ct. at 1406. Thus, arbitration clauses in contracts must be examined both to determine if they are

still valid and to ensure maximum protection. In this regard, clients should be aware of three alternatives.

Clients may obtain greater protection under any of the following options: (a) providing that state law is controlling (and identifying the specific state); (b) providing that common law is controlling; or (c) providing for a level of review before any right to confirm the award in court. Despite the additional protection afforded by these options, clients must bear in mind that no one option is foolproof in the current arbitration environment.

Under the first option, contract parties may agree that the New Jersey arbitration statute applies. However, federal preemption remains an obstacle because many states, including New Jersey, have adopted uniform arbitration laws that are similar to the FAA. Thus, even if a state arbitration statute had been liberally interpreted to allow for expanded review, in light of *Hall Street*, a court may now take a narrow review of arbitration awards

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Actual resolution of legal issues depends upon many factors, including variations of facts and state laws. This newsletter is not intended to provide legal advice on specific subjects, but rather to provide insight into legal developments and issues. The reader should always consult with legal counsel before taking action on matters covered by this newsletter.

Mortgage Loan Refinance and Home Purchase

By Susan Marra

At a time when mortgage rates are at historically low levels and there are so many homes on the market, many are considering whether to refinance the loan on their current home or buy a new home. Is now the time to refinance your mortgage loan or buy a home? Although ultimately a personal decision, there are factors to be considered in making that decision.

Refinancing Your Current Loan

If you intend to stay in your home for some time and have a higher interest rate than currently available, now may be the time to refinance your loan at a lower rate. When is refinancing right for you?

- The new loan will be appropriate for your circumstances. Each person has a different life and financial situation. Someone nearing retirement may opt to convert to a loan with a shorter term, while a longer term may be right for a young couple. If you currently have an adjustable rate loan, you may consider refinancing to a fixed rate loan to avoid uncertainty in the future. Refinancing to consolidate debt or finance a home improvement may be what is needed at this juncture of your life.
- You've done the math and the numbers work. Although closing costs will be incurred, the expenses for a loan refinance are significantly less than those for the purchase of a home. If refinancing to save money, you should intend to stay in your home long enough to recoup the closing costs.
- You will qualify for the loan. Loan standards have tightened. You will need a good credit score, a job and sufficient equity in your home. If you anticipate that the value of your home will decline, it may make sense to refinance now rather than later when the equity in your home may be less, making refinancing more difficult. Refinancing now rather than later may also make sense if you anticipate a layoff or income reduction which may make qualifying for a loan in the future harder.

Buying a New Home

Buying a new home represents a great personal achievement and the possibility of financial reward. However, a home purchase is not without risk. When does it make sense to purchase a new home?

- You have crunched the numbers and you can afford the home and its upkeep and have a reasonable contingency fund for its maintenance and repair.
- You intend to stay in the home for some time. Traditionally, financial advisors have suggested that you plan to remain in the home for seven years. You have a steady and secure source of income. If you are in a field or job expecting layoffs, taking on additional debt for a larger home may not make sense but downsizing to a smaller home may.
- You have considered the fact that your home may not appreciate and, in fact, may decrease in value. Home value appreciation is not guaranteed. However, the interest rate on your loan is also a factor. If you intend to stay in your home for some time, the cost of a home at a higher price with a low interest rate loan may, over the long run, be more affordable than a lower priced home with a higher interest rate loan. You have a personal emergency fund to cover unexpected expenses from loss of a job, illness of a loved one or other financial crisis. Experts suggest a minimum savings of six months of living expenses.
- You can qualify for the mortgage loan. In this market, usually you will need a good credit score, a job and a downpayment of at least 5%.

There are numerous internet sites designed to help you determine if refinancing or buying is right for you. They include:

www.realestate.yahoo.com
www.hsh.com
www.realestate.msn.com
www.bankrate.com

If you have any questions regarding this article, you may contact the

author Susan M. Marra at direct dial number (201) 498-8521 or via e-mail at smarra@HertenBurstein.com, or the Chair of the Real Estate Department Arnold D. Litt at direct dial number (201) 498-8520 or via e-mail at alitt@HertenBurstein.com.

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where the standard to review in the FAA and the state arbitration statute are similar.

Second, clients may agree to use common law instead of federal or state arbitration statutes as the standard of review, as would be the case with an ordinary contract interpretation. This option, however, risks a judicial finding that arbitration clauses are not ordinary contracts and that state or federal law must be applied regardless of the parties' original intentions.

Third, clients may agree to include an appellate level of review in their contractual arbitration clause. Not only could parties identify who would conduct the review but also the desired standard of review, including, for example, a mistake of law. Thus, a substantive error could be corrected before an arbitration award is confirmed by a court. This option, of course, diminishes the cost-savings benefit a more streamlined arbitration process offers.

In conclusion, clients must understand the ramifications of contractual arbitration clauses given the narrowing effect of *Hall Street* and should have their arbitration clauses reviewed and revised to protect them from errors both in the arbitration process and in arbitration awards.

The firm wishes to thank Tanja J. Fagan for her contribution to this article.

If you have a contract arbitration clause that needs review or any other contract or litigation matter, please contact Jason T. Shafron.