

Cross-Option Agreements Explained

This article considers Cross-Option Agreements and their use in owner-managed companies.

Many of my clients are small and medium enterprises run by owner-managers who have a shareholding in the company. The issue they often face is what is to be done if one of the owner-managers falls seriously ill or passes away? Can the remaining owner-managers agree to buy their colleague's shares in the company? Can the family of the individual compel the remaining shareholders to buy their shares? Cross-Option Agreements are used to cover such situations.

I would always recommend that Cross-Option Agreements are entered into by owner-managed companies. They will prevent disruption to the business of the company in the event of a death or serious illness. A Cross-Option also provides peace of mind by ensuring that the family of a deceased owner-manager will have a willing cash buyer in the event of their death, rather than a share in a business which they may neither need nor want.

A Cross-Option Agreement grants each owner-manager an 'option' for their shares in the event of their death. This does two things:

1. Grants the surviving owner-managers a right to buy the deceased's shares; and
2. Enables the family of the deceased to compel the remaining owner-managers to buy the deceased's shares.

The option is usually covered by life insurance policies taken out by each owner-manager to ensure there is always a pot of cash available to purchase the shares and avoid cash flow issues.

Cross-Option Agreements can also be drafted to operate in the event of a terminal or critical illness to one owner-manager. This would enable the ill owner-manager to compel a purchase of their shares by the other owner-managers, enabling them to step back from the business and be properly remunerated for doing so. However, in contrast to the position on death, they cannot be compelled to sell their shares by the remaining owner-managers. The option is only to allow the ill party to either release funds that they have invested, or to enable them to arrange their affairs prior to their death.

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