

SAMPLE DOCUMENT

ESCROW AGREEMENT TO ADMINISTER BUY-SELL AGREEMENT

– Sample for the use of legal counsel only –

This is an agreement between [Names of Shareholders or Partners] (the “Owners” or, individually, the “Owner”) and [Name of Business], a [State of Business Formation] Corporation (the “Corporation”) [Partnership (the “Partnership”)] and [Name of Escrow Agent] (“Escrowee”). The Owners (including any persons who later become a party hereto), the Corporation [Partnership] and the Escrowee are sometimes referred to as the Parties. This Agreement is effective as of the date when all of the Parties have signed it.

BACKGROUND INFORMATION

- A. The Owners are parties to a Buy-Sell Agreement dated _____, 20____, for the disposition of an Owner’s Business Interest under that Agreement, a copy of which is attached hereto as Exhibit A.
- B. The purpose of this Escrow Agreement is to provide that, through the agency of the Escrowee, the Buy-Sell Agreement is to become self-executing;

THEREFORE, the Parties agree as follows:

1. Definitions.

- (a) Business Interest shall mean the shares of the Corporation [Partnership interests] held by an Owner and subject to the Buy-Sell Agreement.
- (b) Buy-Sell Agreement shall mean the Owners’ buy-sell agreement dated _____, 20____, attached hereto as Exhibit A.
- (c) Owner or Owners shall mean, initially, the parties so identified in the first paragraph of this document and, thereafter, any individual who becomes bound by the Buy-Sell Agreement.
- (d) Remaining Owners shall mean all Owners except for the Seller.
- (e) Seller shall mean an Owner who is required to sell a Business Interest under the Buy-Sell Agreement.
- (f) Triggering Event shall mean an occurrence which, under the Buy-Sell Agreement, requires one or more Owners to sell and one or more Owners to buy a Business Interest.

This sample document is intended only as guidance for the client’s own legal counsel. The document is general in nature and does not reflect the specific circumstances of any individual or situation. The document does not constitute tax or legal advice and cannot be used to avoid any penalties that may be imposed on a taxpayer. It is intended that the client’s legal counsel will modify the document where necessary to satisfy the client’s objectives and the requirements of any applicable federal, state or local law. Northwestern Mutual does not guarantee the effectiveness of this document and is not responsible for any tax or legal consequences resulting from use.

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2. Deposit with Escrowee. The parties shall deposit the following with Escrowee:

- (a) Each Owner shall deliver to the Escrowee all certificates for such Owner's shares in the Corporation, including any additional shares hereafter acquired and subject to the Buy-Sell Agreement, endorsed in blank [a power of attorney in favor of the Escrowee relating to such Owner's entire Partnership interest, including any additional Partnership interests hereafter acquired and subject to the Buy-Sell Agreement].

NOTE: OPTION 1 PRESCRIBES THAT THE INDIVIDUAL OWNERS TRANSFER LIFE AND DISABILITY POLICIES OWNED BY THEM TO THE ESCROW AGENT. OPTION 2 PRESCRIBES THAT THE BUSINESS TRANSFER SUCH POLICIES OWNED BY IT TO THE ESCROW AGENT.

[OPTION 1]

- (b) The Owners shall execute changes of ownership and beneficiary designations for all life and disability insurance policies held by the Owners for the Buy-Sell Agreement, both designations to read: [Name of Escrowee], Escrowee, pursuant to [the name of the Escrow Agreement] dated _____, 20____. All policies shall be listed on Schedule A hereto.

Comment: *If an Owner owns life insurance policies on the lives of the other Owners (i.e., a traditional ownership in a cross-purchase arrangement), transferring such policies to the Escrowee to be allocated to such Owner's Account does not give rise to the "transfer for value" rule. However, if an Owner is a Shareholder, transferring life insurance policies to the Escrowee which are not allocated to such Owner's Account gives rise to the "transfer-for-value" rule; thus, in order to avoid the death benefit being subject to income tax, an exception to this rule must exist (e.g., if the parties are also partners in a partnership elsewhere, the "transfer to a partner of the insured" exception might exist). If the Escrowee is going to buy new policies, paragraph 2(b) is not necessary.*

Comment: *The parties may wish to specify, in column fashion, the exact policies by company, policy number, identity of insured, and face amount. Counsel must determine the specificity sought.*

[OPTION 2]

- (b) The Corporation [Partnership] shall execute changes of ownership and beneficiary designations for all life and disability insurance policies held by the Corporation [Partnership] for the Buy-Sell Agreement, both designations to read: [Name of Escrowee], Escrowee, pursuant to [the name of the Escrow Agreement] dated _____, 20____. All policies shall be listed on Schedule A hereto.

Comment: *A Corporation's transfer of life insurance policies to the Escrowee gives rise to the "transfer for value" rule; thus, in order to avoid the death benefit being subject to income tax, an exception to this rule must exist (e.g., if the parties are also partners in a partnership elsewhere, the "transfer to a partner of the insured" exception might exist). If the Escrowee is going to buy new policies, subparagraph 2(c) is not necessary.*

Comment: *The parties may wish to specify, in column fashion, the exact policies by company, policy number, identity of insured, and face amount. Counsel must determine the specificity sought.*

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3. **Duties of Escrowee Prior to Triggering Event.** Prior to notice of a Triggering Event, Escrowee shall:

- (a) Hold the Owners' Business Interests solely in an escrow capacity for purposes of this Agreement and not in any way as a shareholder or partner. Each Owner shall retain all rights with respect to his Business Interest.
- (b) Purchase life and/or disability insurance on each of the Owners in the amounts listed on Schedule A hereto and name itself as beneficiary of the policies. The application, ownership and beneficiary designations on the policies shall read: [Name of Escrowee], Escrowee, pursuant to [the name of the Escrow Agreement] dated _____, 20____. Escrowee shall have the right to purchase additional insurance on any Owner whenever additional insurance may be reasonably required to carry out the Owners' obligations under the Buy-Sell Agreement. Any additional policies shall be listed on Schedule A hereto and shall otherwise be subject to the terms of this Escrow Agreement.
- (c) Premiums due on each policy owned by the Escrowee shall be paid directly to the insurance company by the Owners according to the ownership interest in policies allocated to an Owner's Account under paragraph 3(d) below, or as otherwise agreed to by the Corporation [Partnership] and the Owners. Escrowee shall have no responsibility for the payment of such premiums.

***Comment:** The Owners may prefer to have Escrowee take over the premium payment function. If so, this obligation, along with the Owner's obligations, should be detailed here.*

- (d) Establish a bookkeeping account ("Account") for each Owner. Escrowee shall allocate to each Owner's Account an ownership interest in each policy except for the policy insuring such Owner's life in the same proportion that such Owner's obligation to purchase a Business Interest bears to the obligations of the other Owners to purchase a Business Interest, excluding the Owner insured of the allocated policy.

4. **Duties of Escrowee Upon a Triggering Event.** Upon receiving notice of a Triggering Event, Escrowee shall:

- (a) Collect the insurance proceeds, but Escrowee shall not be obliged to maintain any litigation to enforce collection until it shall have been indemnified to its satisfaction against all resulting expenses and liabilities of the litigation. No insurance company dealing with Escrowee shall be required to take cognizance of the provisions of this Escrow Agreement or to make inquiry as to Escrowee's authority to act or to inquire as to the disposition of policy proceeds paid to Escrowee.
- (b) If applicable, request the insurance company to waive any disability policy requirement that the buy-out expense actually be incurred, and request immediate payment under the policy, reciting the requirements under this Escrow Agreement as grounds for such waiver. If the request is denied, then, upon receipt of such disability proceeds, shall deliver so much of such proceeds as represents the balance due the Seller on any promissory note as a result of the sale of the Seller's Business Interest under the Buy-Sell Agreement. Any excess proceeds shall be credited in accordance with the ownership interest in such policy or policies reflected on the Remaining Owners' Accounts and then distributed accordingly.
- (c) Deliver so much of the insurance proceeds as represents the purchase price in the Buy-Sell Agreement to the Seller. Any excess proceeds shall be credited in accordance with the

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ownership interest in such policy or policies reflected on the Remaining Owners' Accounts and then distributed accordingly.

- (d) Deliver the Seller's stock certificates to the Corporation with instructions that Corporation shall reissue the certificates in the names of the Remaining Owners in accordance with the proportion purchased by each Remaining Owner pursuant to the Buy-Sell Agreement. The Remaining Owners shall endorse the reissued certificates for transfer in accordance with paragraph 2 of this Escrow Agreement and deliver the same to Escrowee; such certificates shall be held by Escrowee as provided in paragraph 2(a). [Exercise the power of attorney provided to the Escrowee pursuant to paragraph 2(a) to transfer the Seller's Partnership Interest to the Remaining Owners in accordance with the proportion purchased by each Remaining Owner pursuant to the Buy-Sell Agreement. The Remaining Owners shall execute as necessary a power of attorney consistent with paragraph 2 of this Escrow Agreement in favor of Escrowee as to this transferred Partnership Interest.]
- (e) Until Escrowee satisfies itself that it can, on behalf of the Owners, deliver all documents and cash required to properly carry out the terms of a sale and purchase under the Buy-Sell Agreement, Escrowee shall deliver no documents and take no action to consummate the sale and purchase (except collection of insurance policy proceeds) and shall not be liable to any Owner for failure to carry out the terms of this Escrow Agreement under these circumstances.

5. **Reallocation of Insurance.** Subject to paragraph 6 below, simultaneously with Escrowee's delivery of the purchase price and receipt for the sale of the Seller's Business Interest, Escrowee shall reallocate to each Remaining Owner's Account an ownership interest in each policy in which the Seller possessed an ownership interest except for any policy insuring an Owner in the same proportion as provided in paragraph 3(d). Each Remaining Owner shall pay the fair market value of his newly allocated share of the reallocated policies to the Seller within thirty (30) days. The fair market value of any life insurance policy shall be as determined under Treas. Reg. § 1.83-3(e) (or any successor provision). The fair market value of any disability policy shall be the unearned premium.

***Comment:** The above paragraph refers to an income tax treasury regulation to determine the policy's fair market value. This regulation technically applies to transfers of policies from employers to employees, not sales of policies, but it is nonetheless used here because it is the most recent treasury regulation addressing the valuation of life insurance, along with identical provisions in the regulations under §§ 79 and 402. Rev. Proc. 2005-25, 2005-1 C.B. 962, provides a safe harbor valuation formula, which many parties will likely want to use. As an alternative, parties could look to the older gift tax valuation formulas found under Treas. Reg. § 25.2512-6. Under either the gift tax or income tax formulas, with traditionally-valued permanent policies with no surrender charges, the fair market value will generally be close to net cash value.*

6. **Life Insurance.** Notwithstanding any other provision in this Escrow Agreement related to the transfer by any party hereto of a life insurance policy or any interest therein:
- (a) An Owner shall not participate in the transfer of a policy on his own life, nor shall he possess any incident of ownership or be allocated any such interest in that policy by Escrowee, except that the other Owners may direct Escrowee to transfer that policy to the insured Owner if not inconsistent with the Buy-Sell Agreement.

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(b) An Owner shall not purchase, and Escrowee shall not allocate to an Owner's Account, any interest in a life insurance policy insuring another Owner unless the purchasing Owner is a partner of the insured.

7. **No Obligation.** Escrowee shall have no obligation to participate in or oversee any other Agreement or transaction involving the sale of a Business Interest or an insurance policy other than as the Owners jointly direct.
8. **Termination.** This Agreement shall terminate upon the termination of the Buy-Sell Agreement or upon the joint written direction of the Owners, whereupon Escrowee shall return to each Owner any documents, property, and powers transferred by or thereafter allocated to each Owner, or as the Owners jointly direct.
9. **Legal Counsel.** If Escrowee is in doubt as to whether a Triggering Event has occurred under the Agreement and whether it should proceed to execute the provisions of the Escrow Agreement, or if the Escrowee is in doubt as to any other action which it should take under the terms hereof, it may employ legal counsel to give it an opinion on any or all of these questions and may take action on that opinion without being liable to any Owner for damages. The costs of employment of counsel shall be borne by _____.

Comment: The parties may prefer to designate an arbiter or a delegation of arbiters to resolve in binding fashion any questions Escrowee may have. This potentiality is also frequently provided for in the underlying buy-sell itself. If so, a substitute paragraph should identify the provision to which Escrowee should be directed in resolving any questions.

10. **Persons Bound.** This Escrow Agreement shall bind the Owners and their respective heirs, executors, administrators, and assigns, but nothing herein shall be construed as an authorization to any Owner to assign his rights or obligations hereunder. Escrowee shall have no duty to determine or inquire as to either (a) the validity or legal effect of the Agreement or (b) the capacity or authority of any signatories hereto to enter into this Escrow Agreement.
11. **[Name of State] Law.** This Escrow Agreement shall be governed by and shall be construed and enforced in accordance with the laws of [Name of State].
12. **Headings and Gender Neutral.** 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. Any pronoun reference to masculine or feminine shall be read as to accommodate the gender of the Parties.

Comment: This agreement does not provide for compensating the Escrowee. The parties may so provide in this agreement or in a separate writing.

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IN WITNESS WHEREOF, the Parties have hereunto set their hands and seals, the Corporation by its duly authorized officers, on the day and year written opposite the signature.

[NAME OF CORPORATION OR PARTNERSHIP]

By: _____
President [Managing Partner]

Date: _____

Attest: _____

Date: _____

SHAREHOLDERS [PARTNERS]

_____ (SEAL)

Date: _____

_____ (SEAL)

Date: _____

_____ (SEAL)

Date: _____

ESCROWEE [*for individual escrowee*]

_____ (SEAL)

Date: _____

[NAME OF CORPORATE ESCROWEE]

By: _____

Date: _____

Attest: _____

Date: _____

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SCHEDULE A
Amounts of Insurance
Held by Escrowee

DISABILITY:

Insured & Policy Number	Total Coverage	Account For		
		<u>Anderson</u>	<u>Brown</u>	<u>Carlton</u>
Anderson Policy # D111-11-111	\$800,000		50%	50%
Brown Policy # D222-22-222	\$800,000	50%		50%
Carlton Policy # D333-33-333	\$800,00	50%	50%	

LIFE INSURANCE:

Insured & Policy Number	Total Coverage	Account For		
		<u>Anderson</u>	<u>Brown</u>	<u>Carlton</u>
Anderson Policy #44-44-444	\$1,000,000		50%	50%
Brown Policy #55-55-555	\$1,000,000	50%		50%
Carlton Policy #66-66-666	\$1,000,00	50%	50%	

Comment: This sample schedule assumes that Anderson, Brown and Carlton each own one-third of the corporation stock (or one-third of the Partnership, as the case may be), that the total value of the Business Interests is \$3,000,000, and that each wishes to buy interests proportionately from each other.