**Sample document only – clients must consult legal counsel**

**One-Way Buy-Sell Agreement between
Sole Business Owner and Key Employee(s)**

This sample agreement has been prepared as a guide to assist attorneys. It contains the basic provisions that are usually included in such agreements. Our publication, *Insurance-Related Best Practices Guide for Buy-Sell Agreements* (BB11258), discusses some of the pertinent issues to consider in drafting such agreements. **As a sample agreement, this document cannot be used as a final draft without modification and consultation with the client’s attorney.** The Client must seek legal counsel to modify the agreement for the client’s particular circumstances. The Client’s attorney is responsible for the final draft of the actual agreement. The use of this agreement does not create an attorney-client relationship between the client and Principal Financial Group or any Principal employee.

This sample agreement might be used to transfer a business entity (regular “C” corporation, S corporation, single member LLC, or sole proprietorship) from a single owner (or an owner and spouse, if the death or disability of one would trigger a sale by both) to participating key employee(s) upon a designated buy-sell triggering event.

Death and disability are included as mandatory buy-sell triggering events under this sample agreement. Each key employee will typically own insurance on the business owner and will be the beneficiary of the policies he or she owns. The Agreement is written to build a very strong contractual requirement to use the insurance proceeds to complete a purchase and sale of the business entity upon the death of the business owner.

The sample agreement also includes a Right of First Refusal provision applicable to a proposed sale of the business entity by the current owner to an outside party.

The sample agreement does not include provisions giving purchase options to the participating key employee(s) upon withdrawal from employment of the business owner, personal bankruptcy of the business owner, transfer of stock to the spouse of the business owner under a divorce decree, or retirement of the business owner. If such provisions are desired by the parties, the client’s attorney should draft and add them to the sample agreement.

A sample Acceptance of the Agreement form for the spouse of the owner to sign is also provided for consideration.

The Agreement assumes two key employees purchasing the business entity from the sole business owner, and would need to be modified if there are more or less key employees purchasing the business.

**Sample document only – clients must consult legal counsel**

**One-Way Buy-Sell Agreement**

This Agreement, entered into this \_\_\_\_\_\_\_\_\_\_ day of \_\_\_\_\_\_\_\_\_\_, 20\_\_\_\_\_, by and between (Name) of (Address) , hereafter called the "Owner," and (Name) , of (Address) , and (Names of participating employees) , of (Address) , hereafter called the "Employees";

**Witnesseth:**

**Whereas**, the Owner is sole owner of (name of entity), a (state or Commonwealth in which business is organized) (corporation/limited liability company) with its principal place of business located at (Address) , hereinafter referred to as “the Business”;

[ALTERNATE PARAGRAPH FOR SOLE PROPRIETORSHIP

**Whereas,** the Owner is sole proprietor of a sole proprietorship doing business as (name of sole proprietorship) with its principal place of business located at (address) , hereinafter referred to as “the Business”;]

**Whereas**, the Employees have been valuable and efficient employees of the Owner and have assisted in the management and operation of the Business;

**Whereas**, the Owner wishes to provide for the purchase and sale of the Business in the event of said Owner's death or disability;

**Whereas**, the Owner wishes to provide that upon such purchase and sale the value of the Business will be preserved and passed on to the Owner or Owner's estate; and;

**Whereas**, the Employees desire to purchase the following percentages of ownership as hereafter provided:

 Name %

 Name %

**Whereas**, it is the intent of the Employees to secure this Agreement by the use of life insurance and disability buy-out insurance on the Owner to provide all or a substantial part of the purchase price when needed to carry out this Agreement;

**Now therefore,** in consideration of the mutual covenants to buy and sell and the performance thereof expressed herein by the parties, each do hereby bind themselves, their heirs, executors, administrators and assigns, and hereto agrees as follows:

**1. Restriction on transfer of the business.** Except in the normal course of business financing, the Owner shall not sell, assign, transfer, pledge or dispose, or otherwise encumber the Business assets except as provided below.

[***Note to Counsel****: If the Business is taxed as an S corporation, it may be helpful to add the following language:*

Furthermore, so long as the Business is subject to an election to be taxed as an S corporation under the Internal Revenue Code, the Owner will not engage in any transfer that would have the effect of revoking that election.]

**2. Right of first refusal.** In the event the Owner desires to sell his/her interest in the Business during his/her lifetime, he/she shall be precluded from selling the interest to any person or institution until he/she has offered to sell it to the Employees according to the percentages set out above, at the price and under the terms provided in Articles 5 and 6 of this Agreement. The Employees shall have \_\_\_\_\_ days within which to accept this offer to sell. If an Employee does not wish to purchase the interest allotted to him/her, the remaining Employee(s) shall have the right to purchase the interest over which the right has been waived in the same proportion as the interest of each Employee exercising his/her right to purchase bears to the total interest owned by all Employees exercising their right to purchase. If the Employees do not purchase the interest within \_\_\_\_ days, then the Business may be sold to such other person or institution; provided, however, that the purchase price shall not be less than that established under this Agreement without first offering it to the Employees at such lesser price and allowing the Employees \_\_\_\_\_\_\_ days to decide on purchasing the interest at such lesser price. If the Employees do not accept the offer to purchase at this lesser price, the Owner may dispose of the Business for such lesser price.

[ALTERNATIVE RIGHT OF FIRST REFUSAL LANGUAGE (RIGHT OF FIRST REFUSAL PURCHASE PRICE AND TERMS MUST MATCH OUTSIDE OFFER PRICE AND TERMS)

**2. Right of first refusal.** In the event the Owner desires to sell his/her interest in the Business during his/her lifetime, he/she shall be precluded from selling the interest to any person or institution until he/she has offered through written notice to sell it to the Employees, according to the percentages set out above, at the price and terms of the outside offer. A copy of the offer to purchase, dated and signed by the proposed buyer, shall be attached to the written notice to the Employees. The Employees shall have \_\_\_\_\_ days within which to accept this offer to sell. If an Employee does not wish to purchase the interest allotted to him/her, the remaining Employee(s) shall have the right to purchase the interest over which the right has been waived in the same proportion as the interest of each Employee exercising his/her right to purchase bears to the total interest owned by all Employees exercising their right to purchase. If the Employees do not purchase the interest within \_\_\_\_\_ days, then the Business may be sold by the Owner to such outside party at the price and terms outlined in the written notice.]

**3. Sale upon disability.** In the event that the Owner becomes disabled, as defined below, then the Employees shall purchase and the disabled Owner shall sell, all the interest in the Business now owned or hereafter acquired. The purchase or sale price and the terms of payment for such stock shall be determined in accordance with the provisions of Articles 5 and 6 of this Agreement.

**Definition of disability.** For purposes of this Agreement, the term "disability" shall mean either:

1. Owner is insured under a disability buyout insurance policy owned by the Employees (listed in Schedule B) and is disabled under the definition of, and for the elimination period specified in, that policy **or**,
2. If there is no disability buy-out policy in force on the Owner at the time a potential disability occurs, then a determination that the Owner is unable to perform the required duties of his/her job for a period of at least [180 or 365] consecutive days, shall be made by a licensed physician, agreed to by all parties to this contract, including the potentially disabled Owner.
3. The physician shall be agreed upon and contracted for services no later than fifteen (15) calendar days from the date (“Notice of Potential Disability Date”) that Owner provides written notice to the Employees of a potential disability event. The parties shall endeavor to obtain the physician’s findings within 30 days of examination.
4. If the parties are unable to agree on a physician in the time allowed, then each party will select and contract with a physician and the two physicians shall select a third. The third physician shall be agreed upon and contracted for services no later than forty-five (45) days after the first physician is selected. A binding determination of disability will be reached if two of the three physicians agree that the Owner is disabled no later than thirty (30) days of the last physician examination.
5. The Owner and Employees agree that the Business will pay for all physician services engaged in reaching a determination of disability under this Agreement.

*[****Note to Counsel:*** *The use of a mandatory disability buyout provision should be carefully considered, taking into account the circumstances of the owner. This sample agreement assumes that the owner is actively involved in the management of the business. In the case of a founder of a family business, for example, or an owner who is not actively involved in the management of the business, the owner might not wish to provide for a forced buyout upon disability.]*

**4. Sale at death.** Upon the death of the Owner, the Employees shall purchase and the estate of the deceased Owner shall sell all the interest in the Business, now owned or hereafter acquired. The sale shall occur within such time as the parties may agree, but in no event shall the sale begin more than \_\_\_\_\_ days after the qualification of the deceased Owner's legal representative. The purchase or sale price and the terms of payment for such stock shall be determined in accordance with the provisions of Articles 5 and 6 of this Agreement.

**5. Determination of purchase price.**

1. The purchase price for the Business under this Agreement shall be based on its fair market value as described below in Paragraph D.
2. For death, corporate financial information shall be used as it existed immediately prior to the date of the Owner’s death.
3. For disability, corporate financial information shall be used as it existed immediately prior to the beginning of the elimination period specified in the disability buy-out policy listed in Schedule B. If there is no disability buy-out policy in place on the Owner, then the valuation date for purposes of this Article shall be immediately prior to the Notice of Potential Disability Date as described in Article 3.
4. **Determination of fair market value.**

*[****Note to Counsel****: The sample valuation method alternatives provided below should be reviewed for financial, tax, and legal impacts prior to the selection of a method for the Agreement. Upon advice from legal and tax counsel, the parties shall select one valuation method for inclusion in the Agreement. Other methods of establishing a company’s fair market value, not included here, may also be appropriate.]*

**VALUATION METHOD ALTERNATIVE ONE: AGREED VALUE WITH APPRAISAL BACK-UP**

 At the end of each fiscal year, or within 30 days thereafter, the Owner and Employees shall redetermine the value of the Business. Said value shall be endorsed on Schedule "A" attached hereto and shall be signed by and binding on all parties to this Agreement. The endorsement shall be in the following form:

The value of the (Name of Business) for the purpose of the Insured Purchase Agreement dated , 20**\_\_\_\_**, shall be $ .

If the Agreed Value has not been updated within eighteen months prior to the buy-sell trigger, then an appraisal process shall be used to establish fair market value. The Employees and the Owner, or his/her legal representative or executor in case of death, shall mutually agree upon an appraiser. If the parties to the Agreement are unable to mutually agree upon an appraiser within 30 days from the date of the buy-sell trigger, the parties shall each name an independent business appraiser qualified as a Certified Business Appraiser (CBA), Accredited Senior Appraiser (ASA), CPA accredited in business valuation (CPA/ABV), or Certified Valuation Analyst (CVA). If the two appraisers cannot agree upon a value within \_\_\_\_\_ days, they shall agree upon and appoint a third appraiser within 30 days of reaching a deadlock over the valuation of the Business. The final fair market value of the Business shall be established by averaging, without weighting, all three appraised values.

 In any determination of value made after the death of the Owner, the value of life insurance death proceeds paid to the Business in excess of the policy's cash surrender value at the time of the decedent's death shall not be taken into account. For purposes of the appraisal, real estate owned by the Business shall be valued at its current fair market value, determined by a current real estate appraisal, not its balance sheet value.

 **VALUATION METHOD ALTERNATIVE TWO: FORMULA**

 The following formula shall be used to establish fair market value of the Business:

 [Insert formula here.]

For purposes of this formula valuation, the value of life insurance death proceeds paid to the Business in excess of the policy’s cash surrender value shall not be considered a Business asset or included in the Business’ revenue or income.

 **VALUATION METHOD ALTERNATIVE THREE: APPRAISAL**

 The Employees and the Owner, or his/her legal representative or executor in case of death, may mutually agree upon an independent business appraiser. If the parties of the Agreement are unable to mutually agree upon an appraiser within \_\_ days from the date of the buy-sell trigger, the parties shall each name one independent business appraiser qualified as a Certified Business Appraiser (CBA), Accredited Senior Appraiser (ASA), CPA accredited in business valuation (CPA/ABV), or Certified Valuation Analyst (CVA). If the two appraisers cannot agree upon a value within \_\_\_\_\_ days, they shall agree upon and appoint a third appraiser within 30 days of reaching a deadlock over the valuation of the Business. The final fair market value of the Business shall be established by averaging, without weighting, all three appraised values.

 In any determination of value made after the death of the Owner, the value of life insurance death proceeds paid to the Business in excess of the policy's cash surrender value at the time of the decedent's death shall not be taken into account. For purposes of the appraisal, real estate owned by the Business shall be valued at its current fair market value, determined by a current real estate appraisal, not its balance sheet value.

 [***Note to Counsel****: For many years it was customary to say that a bona-fide arm's length buy-sell agreement could peg the value of the decedent's interest for estate purposes as long as (1) the purchase price was reasonable at the time the agreement was made and (2) the purchase and sale were mandatory and binding during life, as well as at death. However, under IRC Sec. 2703(b), (applicable to buy-sell agreements entered into or substantially modified after October 8, 1990) the buy-sell agreement value will be disregarded unless: (1) the agreement is a bona-fide business arrangement; (2) the agreement is not a device to transfer property to family members for less than full consideration; and (3) the terms of the agreement are comparable to similar arrangements entered into by persons in arm's-length transactions. IRC Sec. 2703(b). Based on this Code provision, it appears that a buy-sell agreement will not establish an estate value unless the price is set by a provision likely to establish fair market value at the time of exercise using an arm's-length transaction analysis. The appraisal method is just one method which can be utilized to reflect the fair market value of the business at the time of exercise. Other methods of valuation, such as a formula, may be utilized*.]

**6. Terms of purchase.** Upon receiving life insurance proceeds (from the policy or policies listed in Schedule "B" of this Agreement) by reason of the death of the Owner, **or** disability buy-out insurance proceeds (from the policy or policies listed in Schedule “B” of this Agreement) by reason of the disability of the Owner, the Employees must first apply the proceeds to the purchase price of the Business. Any excess of the proceeds over the purchase price shall be retained by the Employees.

In the event that the proceeds of any life or disability buyout insurance owned by the Employees and made part of this Agreement are less than the purchase price, or in the event of any other sale of the Business during the Owner's lifetime, the balance of the purchase price shall be paid in \_\_\_\_\_ consecutive quarterly installments.

The installments shall begin as follows:

1. In the event of death of the Owner, within \_\_\_\_\_ days after the qualification of the deceased Owner's legal representative.
2. In the event of disability of the Owner, within \_\_\_\_ days after the receipt of disability buy-out proceeds, which the Employees will endeavor to collect as promptly as possible. If there is no disability buy-out coverage, within \_\_\_\_\_\_\_\_\_ days after the date the Owner has been determined to be disabled under the terms of this Agreement.
3. In the case of a lifetime sale other than disability, within \_\_\_\_\_ days after the acceptance of an offer to sell the Business pursuant to this Agreement.

The unpaid balance of the purchase price shall be evidenced by promissory notes executed by the purchasing Employees with interest on the unpaid balance determined as of the execution date of the promissory note at the [U.S. Prime Rate, as reported by *The Wall Street Journal*’s bank survey per annum, plus 1%] [Applicable Federal Rate]. The purchasers shall have the right to pay any or all installments prior to the actual due date without penalty.

In the event that the disabled Owner ceases to be disabled after his/her interest has been sold, but prior to the payment of the full purchase price, the remaining balance due to the disabled Owner shall continue to be paid pursuant to the terms of this Agreement.

In the event of default in the payment of principal or interest for a period of \_\_\_\_\_ days, all notes shall become due and payable at the election of the holder.

Each note will be secured in a manner that is acceptable to all the parties to this Agreement.

 [***Note to Counsel****: In determining the rate of interest on the unpaid balance of the note, the parties should be aware of the unstated interest provisions of IRC Sec. 483. The Applicable Federal Rate (see IRC Sec. 1274(d)) is the lowest interest rate that may be charged without resulting in imputed interest under IRC Section 483. However, it may result in a rate that is lower than a market rate of interest. Generally, the prime rate will exceed the Applicable Federal Rate and, thus, will not result in unstated interest.*]

**7. Transfer of business and continuation of business.** Upon receipt of the purchase price in cash and/or notes, as provided in this Agreement, the Owner or his/her legal representative shall transfer the interest in the Business, including the right to continue use of the name, to the Employees.

Upon the death or disability of the Owner, the Business shall continue without interruption, and control and management shall pass to the Employees. Thereafter, the selling Owner or estate of the deceased Owner shall have no further control or management rights in the Business and shall be under no further liability with regard to Business obligations. If the Owner has agreed to be personally liable for debts of the Business, the Business and Employees shall endeavor to release the Owner from such personal liability. During such periods all profits and losses shall accrue to the Employees.

**8. Insurance on the owner’s life.** Each Employee shall apply for and be the owner of life insurance and disability buy-out insurance on the life of the Owner. Additionally, to secure performance of this Agreement, each Employee shall be empowered to purchase, from time to time, additional insurance on the life of the Owner to the extent of the Employee’s proportionate share of the buy-out obligation. Each Employee shall possess the same rights with regard to these new policies as exist with respect to previously issued policies.

All life and disability buyout insurance policies pertaining to this Agreement shall be listed on Schedule "B" attached hereto.

Each policyowner agrees to pay the first and all subsequent premiums as they become due and, if so requested, to give proof of payment to the insured within \_\_\_\_\_ days after the due date of the premium. In the event the premium is not paid within \_\_\_\_\_ days after its due date, the insured may make the payment, which shall be considered a loan, and in such event the insured shall be reimbursed by the policyowner. The policyowner agrees to take all necessary actions to allow disclosure of information to the insured pertaining to the policies insuring his/her life.

No party to this Agreement shall execute any loans against, impair, or in any manner encumber any of the above policies to the detriment of this Agreement without the written consent of the other parties, except that each policyowner may exercise any dividend options or dividend rights provided by the policy without obtaining the consent of any of the other parties to this Agreement.

**9. Right to purchase life insurance.** Upon the death of an Employee, or in the event an Employee withdraws, retires, or is discharged from the Business, the Owner shall have the right to purchase, within \_\_\_\_\_ days thereafter, all contracts of insurance on the Owner owned by said Employee and appertaining to this Agreement.

Upon termination of this Agreement for any reason, the Owner shall have the right to purchase, within \_\_\_\_\_ days thereafter, all contracts of insurance on the Owner owned by the Employees and appertaining to this Agreement.

In all of the above events, the purchase price for each policy shall be as of the date of the purchase, or the policy’s most recent monthly anniversary, the policy’s fair market value following the guidance of Revenue Procedure 2005-25, 2005-17 IRB 962..

If the right to purchase a policy is not exercised, the policyowner shall have the privilege of holding or disposing of said policy at his/her discretion.

[***Note to Counsel:*** *The measurement of fair market value of a life insurance policy varies by the type of policy. IRS Revenue Procedure 2005-25 was not directed at transactions involving a sale or exchange of policies between shareholders; however, it does address a means of determining fair market value for other purposes. It is offered here as a suggested standard for determining policy value. The insurance carrier who issued the policy is in the best position to provide guidance on the fair market value of one of its policies.*]

On payment of the price by the purchaser, the seller shall execute such assignments or releases as may reasonably be required to effect the complete transfer of title to the policy to the purchaser.

**[*Note to Counsel****: For many years, it has been customary for insured purchase agreements to grant the insured the right to purchase the policies on his/her life pertaining to the agreement. However, Rev. Rul. 79-46, 1979-1 CB 303, and Let. Rul. 9349002 determined that an employee's contractual right to buy a life insurance policy on his/her life, owned by the business, is an incident of ownership under IRC Section 2042. In Estate of John Smith v. Comm'r., 73 TC 307 (1979), acq. in result, 1981-1 CB 2, the Tax Court held that the insured's contingent purchase option was not an incident of ownership. Also, in Let. Rul. 9233006, the IRS determined that where a stockholder had the right to purchase the policies on his life if he ceased being a stockholder, such contingent purchase option was* ***not*** *an incident of ownership. Accordingly, Rev. Rul. 79-46 may be of doubtful validity. Even assuming the ruling's validity, it should not result in inclusion of both the insurance proceeds and the decedent's interest in the business in the gross estate. Estate of John T. Mitchell, 37 BTA 1 (1938), acq. 1938-1 CB 20; Estate of Ray E. Tompkins, 13 TC 1954 (1949), acq. 1950-1 CB 5*].

**10. Execution of instruments to effect the terms of the agreement.** The parties hereto, for themselves, their heirs, executors, administrators, successors and assigns, agree to execute any and all instruments necessary to carry out the terms of this Agreement.

**11. Amendment or alterations.** This Agreement may be amended or altered in whole or in part at any time by filing with this Agreement a written instrument setting forth such changes and signed by the Owner and Employees who are parties to this Agreement.

**12. Termination.** This Agreement shall terminate upon the occurrence of any of the following events:

1. The bankruptcy or receivership of either Owner or an Employee; or
2. Cessation of the business; or
3. Death of all Employees within a period of \_\_\_\_\_ days; or
4. Termination of employment of an Employee who is a party to this Agreement, to the extent of that employee’s part in this Agreement; or
5. Written and signed mutual agreement of the Parties.

**13. Notice.** All notices including offers or acceptances, shall be deemed received, if provided in writing and delivered in person to the other party, or mailed by certified or registered mail to the last known address of that party.

**14. Remedies for failure to perform.** If a party to this Agreement defaults or fails to complete his/her obligations under this Agreement, then the offended party may, at his/her option seek damages, or obtain specific performance of the Agreement from a court of competent jurisdiction.

**15. Liability of insurer.** It is understood by the parties to this Agreement that in issuing policies of insurance pursuant to this Agreement, Principal National Life Insurance Company or Principal Life Insurance Company shall have no liability except as set forth in the policies. Said Insurer shall not be bound to inquire into or take notice of any of the covenants herein contained as to policies of insurance, or as to the application of the proceeds of such policies. Rights under a policy may be exercised during the life of the Insured pursuant to the provisions of the policy. Upon payment by the Insurer pursuant to the terms of any policy, the Insurer shall be discharged from all liability without regard to this Agreement or any amendment thereof.

**16. Governing law.** This Agreement shall be governed by the laws of the state [Commonwealth] of \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_.

**In witness whereof,** the parties hereto have set their hands and seals the day and year above written.

(Formalities of execution will be

governed by local law and should be

in accordance therewith.)

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(Signature of Owner) (Owner name – print)

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(Signature of Employee) (Employee name – print)

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(Signature of Employee) (Employee name – print)

**Acceptance of Agreement**

I, (Name) , spouse of (Owner) , have read the foregoing Agreement and I agree to the provisions relating to the sale of a Business assets interest and I do agree that the provisions shall be binding on me while this Agreement may remain in effect.

This acceptance is executed by me at the same time my spouse is executing the said Agreement.

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

(Signature of Spouse) (Spouse name – print)

**Schedule “A”**

FIRST ENDORSEMENT:

The value of the (Name of Business) for the purpose of the Insured Purchase Agreement dated , 20\_\_\_\_, shall be .

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

(Owner) (Date)

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(Employee) (Date)

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(Employee) (Date)

**Schedule “B”**

**Life Insurance and Disability Buy-Out Policies**

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Insured Policyowner Insurance Co. Policy No. Amount

\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_

Insured Policyowner Insurance Co. Policy No. Amount