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Business Succession Planning Guide

Congratulations on taking the first step to protect your interest in your co-owned business. Business Succession Planning is essential for protecting your interest in a co-owned business and is an integral part of every business co-owner's individual Estate Planning.

"Business Succession Planning" means:

1. Planning for the sale or purchase of a co-owners' interest in a business in the event of their death, permanent disablement, serious illness/trauma or other circumstances and funding for that sale/purchase, (See **Buy/Sell Option Agreements** below), and
2. Planning for the preservation and growth of co-owners' equity in a business by the implementation of agreements between co-owners governing the management and decision making of the business and ability to dispose of an interest/share (See **Shareholders' Agreements** below).

Problems associated with a business co-owner suffering an untimely death or injury, as well as disputes between co-owners, both of which often lead to the financial ruin of a business, can be managed or avoided by the consideration and implementation of suitable Business Succession Planning Agreements and related insurances. The avoidance of these problems will ultimately protect you and your family and preserve your Estate assets.

Where to Start?

If you are a co-owner of a business you should at the very least consider the benefits for you and your family of having proper Business Succession Planning Agreements in place. The information below will assist, however, please feel free to call and speak to one of our Commercial Lawyers should you have any questions (02 4952 3901).

To assist you to discuss issues relevant to Business Succession Planning with your business co-owners we have prepared the following Terms Sheets:

- Terms Sheet – Buy/Sell Option Agreement, and
- Terms Sheet – Shareholders' Agreement.

The Terms Sheets are available from our website and are designed to facilitate meaningful discussions and negotiations between co-owners so that a majority of issues can be agreed before you contact us to discuss the preparation of relevant Business Succession Agreements on your behalf. This document together with the Terms Sheets should be circulated to your fellow co-owners to review and a date set to sit down and discuss the issues raised in them. You should make notes in relation to the matters agreed and further issues that arise from the discussions in the Notes section in the Terms Sheets.

Once you have completed the Terms Sheets please contact one of our Commercial Lawyers with any questions you have and/or make an appointment to attend so that we can discuss your Notes and take instructions for the preparation of Business Succession Planning Agreements for your business.



"Don't risk more than you can afford to lose."



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What is a Buy/Sell Option Agreement?

A Buy/Sell Option Agreement is an agreement between co-owners of a business granting each other options to buy or sell their respective interests upon the occurrence of specified Option Events. The Option Events are typically:

- the Death of a co-owner;
- the Permanent Disablement of a co-owner;
- Serious Illness/Trauma in connection with a co-owner such that they are no longer able to continue to work in the business; and
- the Retirement or Expulsion of a co-owner (although these circumstances would ordinarily be dealt with in a Shareholders' Agreement/Partnership Agreement if one existed for the business).

Enforceable Buy/Sell Option Agreements overcome disputes in relation to the buy out of a co-owner's interest in a business including rights to buy/sell, valuations of interests, timing of payments and funding. Funding Agreements are frequently entered into in connection Buy/Sell Option Agreements and provide for the funding of the price for a co-owner's share in the event that an option to buy or sell is exercised. Funding is usually provided by co-owners taking out personal insurances, agreements in the form of vendor finance or a combination of each.

Why Do I Need a Buy/Sell Option Agreement?

In the absence of a Buy/Sell Option Agreement disputes between co-owners or their executors/beneficiaries following the occurrence of an Option Event are common. These disputes typically relate to:

- Who may purchase the co-owner's interest;
- Whether the affected co-owner or their Executor can insist that the continuing co-owner(s) purchase the relevant interest;
- Whether a deceased co-owner's spouse/children (or other beneficiary) are entitled to keep the interest and participate in the running of business;
- The price to be paid for the co-owner's interest in the business,
- How the price is to be determined in the absence of an agreement, and
- When and how the price is to be paid.

Imagine the implications for yourself and/or your family in the following circumstances which may arise in the absence of a Buy/Sell Option Agreement:

- *You have died unexpectedly:*

However, your co-owners are unwilling or unable to pay your Estate the value of your share in the business. Your Executor/Spouse may be forced to participate in the running of the business until a purchaser can be found. It is likely that your Executor/Spouse will end up accepting an amount significantly less than the true value of your interest in the business in order to realise some capital for the same.

- *You have suffered a permanent disability or serious illness/trauma:*

Again, your co-owners may be unwilling or unable to buy out your interest in the business. You will likely end up not getting anything, or something significantly less than the true value, for your share in the business. If you were relying on the value of your interest in the business to pay off a Mortgage you may now suffer financial hardship and/or be unable to live as comfortably as you would have liked, especially in view of your unfortunate circumstances.



“What if something happens to me or one of my co-owners?”



“I never thought it could happen to me”

- One of your co-owners has suffered a permanent disability or serious illness/trauma or died unexpectedly;

You feel sorry for your co-owner or deceased co-owner's family but either can not afford to buy out their share of the business or do not consider that such a purchase is a good commercial decision for you and your family at the time. You object to the eventual proposed purchaser of the deceased co-owner's share of the business and/or can not agree on management and/or operational decisions. You eventually end up in dispute with the new co-owner. Your equity in the business diminishes or the business fails as a result of the internal dispute.

Alternatively, your disabled co-owner or deceased co-owner's family want to maintain an interest in the business and actively participate in management decisions and operations. You would prefer to buy out the interest in the business but they do not want to sell or demand an unreasonable price. You do not agree with their suggestions for the management operation of the business and end up in dispute. Your equity in the business diminishes or the business fails as a result of the internal dispute.

What is a Shareholders' Agreement?

A Shareholders' Agreement (similar to a Partnership Agreement) is an Agreement between two (2) or more co-owners of a business setting out their agreements with respect to the management and control of the business and roles and responsibilities of each of the co-owners. Shareholders' Agreements also dictate the rights and obligations of co-owners in the event of a dispute or proposed sale of their interest in the business.

Among other things, Shareholders' Agreements regulate the following:

- the Purpose of the Company;
- the Roles and Responsibilities of Shareholders;
- the Appointment and Removal of Directors;
- Remuneration and Indemnity of Directors;
- Board Meetings, Voting and Decision Making on behalf of the Company;
- Management of the Company;
- the preparation and review of Budgets, Business Plans and Financial Information;
- Access to Company Information;
- Funding of the Company, Loans and Guarantees;
- the Issue and Disposal of Shares;
- Drag and Tag Along rights of Shareholders;
- Rights to Acquire Shares of retiring or terminated Shareholders and methods for valuing Shares;
- Dispute Resolution procedures;
- Restrictions on Competition by existing and former Shareholders; and
- Confidentiality of Information.



“What if we can't agree?”

Why Do I Need a Shareholders' Agreement (Partnership Agreement)?

Anyone who is a co-owner in a business should have a Shareholders' Agreement (if the business is carried on by a company) or a Partnership Agreement. These Agreements minimise the likelihood of a dispute by ensuring that the co-owners have considered the objects of the business and their individual roles, rights and responsibilities. Disputes between co-owners who have not entered into a Shareholders' Agreement are more common as there has generally not been any prior consideration or discussion of the co-owners' respective commitment to the business or restrictions on dealing with their interest in the business.

Most people that enter into business together are confident that they can maintain an amicable relationship when running the business, however, where the relationship can not be maintained, co-owners who have not made a Shareholders' Agreement stand to lose considerably more. Disputes in relation to the following are more likely to have a crippling effect on you and/or your business in the absence of a Shareholders' Agreement:

- The direction and growth of the business;
- The appointment or removal of a person as a Director;
- The level and minimum duration of each co-owners' commitment of time and financial resources;
- The denial of a co-owner to relevant information and/or exclusion from decision making;
- The payment of dividends vs the retaining of profits for future growth;
- The issue of new shares to new investors/co-owners;
- The sale of a Shareholder's Shares to an unsuitable third party or without first offering the Shares to the other Shareholders;
- The sabotage by a co-owner of a proposed take-over or merger;
- The right to buy back the Shares of a co-owner who is no longer fulfilling their contribution to the business as originally contemplated;
- The valuation of the Shares of an outgoing co-owner;
- The carrying on of a similar business by a former Shareholder in competition with the business.

The time and cost alone of dealing with any of the above disputes can lead to the financial ruin of a business and total loss of value of a co-owner's equity.

If you are a co-owner of a business, or are considering becoming a co-owner, we strongly recommend that you meet with your co-owners and review and complete the Terms Sheets for Buy/Sell Option Agreements and Shareholders' Agreements. Simply discussing the matters contained in the Terms Sheets may go a long way to avoiding future disputes or influence your decision to become a co-owner.

Once you have completed the Terms Sheets, please contact one of our Commercial Lawyers with any questions you have and/or make an appointment to attend so that we can discuss your Notes and take instructions for the preparation of Business Succession Planning Agreements for your business.

Please feel free to call in at any time if you have any questions. We look forward to working with you and your business in future.



“Have you considered how you will resolve disputes with your co-owners?”