irongroup lawyers

Exit Agreements

Preparing for the departure of a business partner

Introduction

People often have a lot of their wealth tied up in a business. However, when two or more people own a business, more often than not, the departure of one of the owners has not been clearly and properly dealt with in a legally binding manner.

In practical terms, an exit by one of the partners is inevitable, sooner or later. These reasons could include retirement, a disagreement or even a divorce as part of a financial settlement. So, if they have to exit the business - what happens then?

The need for an appropriate legal agreement between partners may seem painfully self-evident - but some sources indicate that as many as 95% of businesses may not have the right kind of agreements in place!

This can lead to immense problems not only for the departing proprietor, but also for the business and the remaining business owner(s).

An Irongroup Lawyers Exit Agreement can be put in place to dictate the terms under which a partner can depart the business. Without such an agreement, the following scenarios are unfortunately quite common:

-Departing partner(s) are suddenly under pressure when negotiating with

the remaining partners to sell their share of the business.

- The value of the business will be under contention because of the conflicting interests.

- The departing partner may be forced to take whatever is on offer.

The remaining partners may find themselves with a new (and unwanted) partner if they don't have the first right to buy the business from the departing partner.

Whatever the situation, it is potentially fraught with emotion, cost, and dangerous distractions from running the business.

A significant part of someone's wealth can suddenly be at risk - and can leave everyone involved unhappy with the ultimate outcome.

Irongroup Lawyers Options

An Irongroup Lawyers Exit Agreement is an agreement between business owners that sets out the terms under which a partner can exit the business.

Irongroup Lawyers offers business owners two options. The first is a non-compulsory agreement whereby one partner must give the other(s) the first right of refusal to buy their share.

This type of agreement however, puts them under no obligation to buy that share.

The second option is a compulsory agreement. Under this option the departing partner can force the remaining partner or partners to buy their share of the business.

This has very quickly become the preferred option amongst business owners.

As a result of the binding nature of this agreement, there are usually conditions that apply.

From a fairness perspective, most business owners agree that a 'penalty' should be imposed on the owner electing to leave.

If a penalty is applied, it usually takes the form of a discount on the value of the business as well as attractive payment terms.

The discount on the valuation acts as a form of disincentive to the departing partner. After all, they are potentially disrupting the business and putting the remaining partners under pressure. Conversely, it also provides an incentive to the remaining partner(s) to buy the shares and take on the risk of owning the whole business.

Payment terms also assist in this regard. Usually the terms agreed to are such that

Special Offers

1. **Free phone call** with a lawyer to discuss how these agreements work. Please call us to organise a time.

2. **Free review of your Partnership Agreement.** If you want to ensure your existing agreement is appropriate, we will review it obligation-free. Please email us a copy.

Irongroup Lawyers (Aus) Pty Ltd ACN 626 171 177
Level 8, 533 Little Lonsdale St. Melbourne VIC 3000
P: 03 8621 9000 E: info@irongrouplawyers.com
www.irongrouplawyers.com

LAW INSTITUTE OF VICTORIA ACCREDITED SPECIALIST

Specialists in Wills & Estates

Exit Agreements…

they allow the remaining partners to fund the buyout from the future cash flow. Again, this acts as an incentive to the remaining partner(s) as it helps ensure they can fund the buyout.

These agreements are all tailored to suit you but at a minimum the terms will include:

- The agreed method of valuation of the business at the time of departure (usually an independent valuation).

- The discount to apply (if any) to the valuation as a form of compensation for the remaining partner.

- The payment terms applicable - both the term and possible interest payable. Again, this varies and is usually a function of cash flow and business value.

Funding

The continuing partner will need to source the funds over the agreed term with which to pay the departing partner. These funds can be obtained from their own resources or from the cashflow of the business.

Extreme circumstances

If required, the agreement can also enable a partner to force another partner to transfer their equity to the remaining partners in circumstances such as bankruptcy, fraud, mental incapacity or non-performance.

We sometimes recommend that the purchase price be a decreased percentage of the terminating partner's equity value e.g., in the case of fraud or bankruptcy.

This is because it usually means that the terminating partner has done something illegal and/or potentially damaging to the business and should be 'penalised'.

The usually accepted terms are a purchase price of 100% for non-performance or mental incapacity and 50% for fraud and bankruptcy payable by 4 equal annual instalments, without interest. Again, however, it is your decision.

Capital Gains Tax

Capital Gains tax is payable by the departing partner and needs to be taken into account in the payment terms to ensure the tax can be paid as required.

In Summary...

Whenever two or more people own a business it is essential to have a well-planned Exit Agreement in place to help ensure their investment is protected.

The agreement should ideally be implemented while neither party is under pressure, to maintain equal negotiating power.

Agreeing on these terms and putting the appropriate documents in place is not an expensive or difficult task.

The Process

Irongroup Lawyers prepares fixed price Exit Agreements. We meet with you and often your Financial Adviser, either in person or via a teleconference meeting.

We discuss the issues and options with you and collect all relevant details. Once the key issues are agreed, we then prepare the agreement and send it to you for review and signing.
It's also important to review your agreement annually to ensure it continues to reflect current needs.

"Involuntary" departures

An Exit Agreement is used to cover the exit of a partner for 'voluntary' reasons. The other possibility however, is when an owner 'departs' as a result of a death, illness or total and permanent disablement.

Terms and conditions for these events are covered in another agreement called a Buy Sell Agreement. Issues to considered as part of preparing that agreement include:

- What 'events' do the owners want to trigger the agreement? e.g., Death, TPD, Critical Illness?

- How will they fund the buy-out?

- How will they set the purchase price?

- What are the capital gains tax implications?

Irongroup Lawyers can also prepare these agreements when required, providing the complete Business Succession package.

Contact Us

For more information on either Buy Sell Agreements or Exit Agreements, please call us on **03 8621 9000** or send us an email **info@irongrouplawyers.com**.

With our depth of experience, fixed prices and focus on providing positive outcomes for clients, we would be pleased to help.

©Irongroup Lawyers 2023