



# Lord

## Commercial Lawyers

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# Legal Bulletin

## BUY-SELL AGREEMENT OR BUSINESS SUCCESSION AGREEMENT

If your business is a company or partnership in which the ownership and management are corresponding, entering into a buy-sell agreement now can go a long way to avoiding problems at a later point.

### WHAT IS A BUY-SELL AGREEMENT OR BUSINESS SUCCESSION AGREEMENT?

A Buy-Sell Agreement or Business Succession Agreement allows the remaining owners of a business to acquire the interest of a resigning shareholder or partner. A Buy-Sell Agreement or Business Succession Agreement will usually restrict an owner's ability to transfer their interest as a shareholder or partner. A well written Buy-Sell Agreement or Business Succession Agreement also provides the terms under which the remaining owners may or must acquire a resigning owner's interest on certain specified events.

### WHY SHOULD YOU HAVE A BUY-SELL AGREEMENT OR BUSINESS SUCCESSION AGREEMENT?

- To prevent outsiders or heirs from obtaining an ownership interest in the business without you first having the opportunity to purchase the interest;
- To ensure the continuity of the business notwithstanding the death, retirement, bankruptcy or expulsion of an owner;
- To ensure continuity of management;
- To prevent the continued involvement in the business of retired or inactive shareholders or partners;
- To create a certain market and value for the shares of deceased, retiring or withdrawing shareholders or partners;
- To provide cash to an estate.

### WHEN SHOULD A BUY-SELL AGREEMENT OR BUSINESS SUCCESSION AGREEMENT GO INTO EFFECT?

The most common events which will trigger a buy sell agreement are:

- On an attempt to sell: When a shareholder or a partner seeks to sell his or her interest in the business, the

remaining shareholders or partners can retain a right of first refusal on the same terms as a third-party may offer or at a price set in the Buy-Sell Agreement.

- **On Death:** The death of a shareholder or partner triggers an obligation in the agreement to purchase the interest of the deceased; the purchasers would be the entity or the surviving shareholders or partners.
- **On Retirement:** The agreement may provide that shareholders or partners who are active in the business may or shall retire at a certain age or after a specified period of service, with their interest being purchased by the other owners.
- **On Disability:** The disability of a shareholder or partner who has been active in the business may trigger a buy out. The agreement would define "disability" and the means of determining the disability.
- **On Expulsion or Termination of Employment:** A partner or a shareholder's voluntary termination of employment or expulsion from the business may trigger a buy out.
- **On Bankruptcy:** An owner's bankruptcy or assignment for the benefit of creditors may also trigger a buy out.
- **On Loss of License or Death of Licensee:** Loss of a professional license by a shareholder or partner usually triggers a mandatory buy-sell obligation, to assure continued compliance with professional obligations.

### FUNDING A BUY-SELL AGREEMENT OR BUSINESS SUCCESSION AGREEMENT WITH INSURANCE

A crucial issue where there is a buy out by an owner is whether the purchasers will have the necessary funds. Because so few businesses have sufficient cash or other resources to fund a buy out, the seller usually must accept an instalment payout and continue to share the risks of the future profitability of the business, unless the business has provided for a fund to buy out a major owner. There are essentially three methods for funding a buy out: (1) borrowing from a party, (2) setting up a sinking fund or reserve, or (3) acquiring insurance.



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Whether life insurance should be used to fund a buy out depends on the nature of the business, the owners' objectives, the buy-sell prices for the owners' interests, and the cost of life insurance, including taxes. These factors will differ according to the type of Buy-Sell Agreement used.

### **ABOUT LORD COMMERCIAL LAWYERS**

*Lord Commercial Lawyers is Melbourne based commercial law firm. The firm is comprised of senior practitioners with extensive experience. We advise on a wide range of commercial business, migration, dispute resolution and personal law. Click here to download our corporate brochure or visit our website [www.lordlaw.com.au](http://www.lordlaw.com.au) where you will find more detail about all our areas of practice and recent publications.*