Talking Law

Episode 120 – Common issues when going into business with someone in the vet industry

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Transcript

Joanna: Hi, it's Joanna Oakey here and welcome back to Talking Law, a podcast proudly brought to you by our commercial legal practice, Aspect Legal. Now today, we have a podcast that's explicitly directed at the veterinary industry. Having said that, it's a topic that is just as relevant to any other industry. So the topic that we're talking about today is the common issues that occur when going into business with someone else and what to do about it. Now I have on the show here; in fact, this was actually a webinar that Paolo Lencioni and I were presenting at quite recently. I thought this was very useful content to bring to you on this podcast. Here, we go with Paolo from APL accountants and Value Vet and I talking about the common issues with going into business with someone else. And just as a hint, here, we talk about the different types of business structures, you can use the risks of not having associated agreements in place, what needs to be covered in a shareholders agreement, because this is something that's a really important consideration when you're going into business with someone else. Number one, having a shareholders agreement in place in the first place, which you hear me talk about, but also what needs to be covered in that shareholder's agreement.

We also cover drag-along and tag-along clauses we talked about the importance of restraints and how that works. And finally, we talk about reviews and exit clauses. So buckle in here we go for all of the insight into common issues when going into business with someone else in a veterinary practice or indeed in any other type of business at all.

Paolo: Hello there, everyone and welcome again to one of our webmaster classes. So great to see everyone's pulling into the room. And for those of you who are decks and spans like my wife, you would have enjoyed that video where we had toting decks and serve and gambler music playing in the background, and quite suiting, I think, at this point, because this web event is if you're ready to take a gamble on having a business partner or going into business with someone else. In the current environment, we see many internal acquisitions in practices, lots of younger vets wanting to buy veterinary practices, which is good to see. We thought it would be good fun and really relevant to have an event discussing partnerships and going into business with someone else. So just a little bit of housekeeping in terms of you know, we will be able to answer questions today. We like the events to be interactive and things. So if you guys do want to ask questions, use the chatbox. Please note the questions and answers. So to access the chatbox on your zoom screen, if you see the three dots saying more, you click on that, and when you click on the box called to chat. And then you'll see a little drop down there that says to just the panelists, which will be the people here presenting or to everyone and if you change it to everyone that everyone can see your question. So unless it's kind of a private dish question, you don't you can you can put that to everyone. It's much more fun. And I'd like you all to do that right now just to verify that you can hear me so just say a big Hello in the chat box. And I'll wait for those chats to come through. If I see nothing, then I'll assume you can't hear me. But we can see quite a lot of people have spelt in. Yeah, I'm getting a Hello there. Hello. Hello. Hello. Hello. exclamation marks even better. I think you can use the emoticons by the way on zoom now. So if someone puts an emoticon on there, obviously. All right, so we can see we're all we're all loud and clear. I can see Yes, yes, James Anthony. Hi, everyone. Perfect. So everyone can hear us really, really nicely. So today we have, we do have a special guest who will introduce to you first because we've done quite a lot of work with Joanna. So here she is coming in on the screen. And I have got screen envy here because she has this wonderful recording studio. Because we know that Joanna is is a podcaster and part of our very very popular legal podcasts in Australia but she also heads the team and has for a long period of time at Aspect Legal. And we've been involved with quite a few sales and acquisitions with Jo in the past. We find it quite a friendly lawyer. It's quite a reaction. So we've done we've done a fair bit of work with Joanna and I'm pretty sure she'll happily answer your questions in a friendly manner if you have any questions coming in on the chat box. So with that Jo, say hello to everyone.

Joanna: Hello Thank you for having me on board. I'm super, super excited to join you today.

Paolo: That's good. So what I'll do now is I'll just quickly switch over to my PowerPoint and I'm just I'm going to do is I'm going to introduce, just very quickly some of the business structures to avoid some conversation. And then the rest of this event really is going to be a media q&a session with Joe around all the things we see that are common common issues around going into business with someone else. So let me just bring that up because a little bit slow on zoom. I'm not I'm not a multitasker. By the

way, guys, as some of you may know. So I have to try speak and fiddle with my zoom screen at the same time. So I think that will work. I think something Yay, there we go. Okay, we're in business. Alright, so first of all, and also Jo, you're part of a part of the B1G1 movement.

Joanna: I am absolutely.

Paolo: And that's actually that's where we met you, we met in one. The B1G1 is an organisation that allows us to give to worthy causes in terms of like, if something special happens in our business, we can do something special for someone else, and quite relevant for this point in time. Thank you, all of you for having attended today. And actually not only for attendees, but for everyone who's registered. For this particular month, we will be giving to the worthy cause of supporting injured Australian wildlife and bushfires because we have those bushfires in Western Australia. So a big thank you to all of you for attending this today, you'll have made a difference to that wallbox in Australia, just by being here. This is Joanna's contact details, by the way, Aspect Legal. So if any of you are interested in anything that Joanna said today, or want to contact Joanna about anything around sales and acquisitions, or partnership agreement, or going into business or some of the agreements around that, and that's the website, www.aspectlegal.com.au. All right. So what we're going to cover today, just briefly, the things that will get covered today is we'll be looking at the business structures and structures and associated agreements with those structures. Jo and I will speak about the common things that the agreements will should be covering. And then we'll be looking at the common issues causing breakdowns in relation business relationships, and we've probably got quite a lot of stories collectively, of where we've seen these things go wrong, because obviously our involvement in Value Vet and buys and sells through the valuation business exposes us to a lot of that, and obviously, Joanna's exposure on the legal side would would expose you to a lot of that. And then we'll be looking at some potential exit options for businesses for people who want to slowly exit the business and and see how that can be done an interesting things like drag-along and tag-along clauses. So just so you guys don't get confused today, we're not going to go through all the like ins and outs of all the different business structures, because there'll be a whole webinar on its own. But understand that, generally, if you're in business with someone else, you'll probably be trading as a company, a unit trust or a partnership. And for all three of these structures. When we talk about agreements, you have to have some kind of agreement in place that deals with the relationship between you and the other associated business parties. In in strict terms, if you are in a company, that agreement will be called a shareholders agreement. If you are in a unit trust, it will be called a unit holders agreement. And if you're in a partnership, it will be called a partnership agreement. Now obviously, when we're dealing with this conversationally and doing, you know, speaking about it, we may talk about, you know, being in partnership with someone or something like that, we're not really talking about partnerships, we'll be covering all these structures, okay, just understand that depending on whichever structuring you're in, when we talk about the agreement, you have to have between yourself and the associated parties in business with you. It'll either be a shareholders agreement, a unit holds agreement, or a partnership agreement. Okay. And if you've got that right, then you should be able to follow what we'll be dealing with quite easily. And I think that's all I had on my PowerPoint because now the rest is just going to be purely conversational.

Joanna: Actually, in that note, one thing I just thought I'd throw in, in that distinction

between the different types of entities that company, the partnership, and the trust, maybe we should also differentiate between the family trust and the discretionary trust versus unit trust, because that discretionary trust is, is more about a structure for an individual who's running a business versus that, you know, the unit trust, which is the, you know, the structure that relates to multiple people together in a business. So I guess that's just one thing to throw out there. Because I, I find quite often there's a lot of confusion about what trusts are and how it actually works. So, you know, and partnerships as well, uh, companies are a little bit perhaps more understood. But the one thing I wanted to point out we're going to be talking about shareholders agreements and Unit holders agreement. I have many people who come to me who might have a unit trust set up and they think the trust deed is the same as a unit holders agreement. or indeed, perhaps people think that constitutions are the same as a shareholders agreement for companies. So just thought maybe it's useful for us to just quickly just talk about that you. So you mentioned the unit holders agreements for trusts. But that is different to the trust deed itself, because the trust deed regulates and how the funds will flow through the trust, ultimately, really, it's setting it up from a legal relationship, just like a constitution does for a company. But the shareholders agreement for a company, or the unit holders agreement for a trust, these extra documents sort of sit over and above those foundational documents that govern the relationship. So just thought I'd throw that in, of course, we're going to talk a lot about what those documents include and where the issues come in when they're not in place. But I just thought I'd add that distinction in initially, because people don't necessarily understand the difference between a trust deed and a unitholders agreement, but they're quite different

Paolo: Thank Jo. So you guys will know, even if we've set up a trust or a company for you. The actual setup process through ASIC requires that, you know, you have a constitution formulated a very standard document, or if you set it up a trust, you get a trust deed, which will be a little book that will give you understand that actually pretty much handles a lot of how the trust works as a legal entity, but does not manage, and correct me if I'm wrong, but does very little to manage the relationship of the parties inside that business. Yeah, and this is what we're actually looking at now is actually you need a separate documents drafted by a lawyer that manages the relationships of the parties inside that business. And a lot of people will be confused. Like I said, Oh, yeah, do you have an agreement in place? And actually what I'm gonna do now is I'm going to launch a little poll, and I just want to see, I want to see who's, who's who our audience is. So really, I'm going to launch this now. And the question is, you know, at what stage are you in business? Are you thinking of buying into your business? Are you thinking of bringing in a partner? Are you already in business with someone? Or are you just curious, and we'll just let that run for about 30 seconds, as we see the numbers coming through. And we're still waiting. It's all it's all going crazy there? Because we've got loads of people here. So there's another Come on another 10 seconds, people are still voting away. There we go. We go on, go on. Go on. Almost everyone's done it. Come on, I can see there's a few you haven't, you know, zoom, lets me check who's voted who hasn't voted

Paolo: We're pretty we're pretty good day. And we'll share the results. And we can see here. So it's actually fairly even. We have 30% thinking of buying into a business. Okay, so this very much reflects what we've been seeing, okay, there's a lot of people interested in buying veterinary practices, lots of veterinarians actually wanting to buy veterinary practices, not corporate, which is fantastic. We really like that does so well

done, then there's Oh, and I think someone's thinking of bringing in a partner 36% of people willing to bring in a partner. So we can see, it's actually a very even number 30 to 36. So there's certainly people wanting to bring in partners, people wanting to go into business 40% already in business with someone else. So we'll have some interesting facts for you there. And 80% just curious. Okay, so that's fantastic. Thanks for sharing that. So we know we have a pretty good audience here. And the information is, it's going to be pretty relevant. Okay, so Jo, I thought we'd probably start off the question, I would say, so you actually brought highlighted the fact of having the separate extra agreement that handles the relationship between the people within the business themselves? What are the risks of not having such an agreement in place, broadly speaking?

Joanna: Yeah, so I usually start off when looking at this. And can I say the risks are disputes, and I'll talk about some of them in a moment because we see lots of them. So we can see what is causing these disputes. And then the issues that the business partners find themselves even if they don't have a document that sort of tells them what to do if they're not agreeing on something. But standing back, you know, the way I view agreements, like for example, shareholders agreements and partner partner partnership agreements and, you know, unitholder agreements is that it gives you the opportunity to discuss it's almost like it's checklists to help you discuss the things that you may not think of to discuss between each other as partners in a business, or that you might feel uncomfortable discussing otherwise, so So putting agreements in place, firstly, is helping you discuss the things that are relevant to how your relationship will run together in running this business, because it is a relationship. And, you know, relationships can often start with a lot of high energy and people getting on, but then over time, can, you know, sometimes disintegrate and turn into something that wasn't what either party thought it would be in the beginning. So the first thing is having agreements in place, whichever it is, I think is a really good way to number one stop disputes from occurring in the first place, because it helps you ask the questions that you should be asking right in the beginning, so that when an issue occurs in relation to you both, you know, seeing how something is playing out in a business in a different way, you've had that discussion from the beginning, and you understand where each other sits, rather than I think the biggest issue is when some of these things fester, without people talking about them, and without understanding each other's perspectives right from the beginning. So right from the beginning, I would say you need to look at these things, not as this like big legal document that sits in the bottom of the drawer. That's not what these agreements are, these agreements are something there to help regulate the behavior that you're each expecting from each other in certain situations. And to help you navigate any disagreements or disputes or come up during the period of relationship together. Now, I think some of the biggest issues we see are really around probably decision making an exit, and we'll probably I think we've got lots of these areas to work through. And I think in our discussions together, you've also seen lots of other things, you know, weighing in there, but but two of the things that we see most prominently, are there's lack of consensus, people are taking different viewpoints in relation to how the business should be run. And there's nothing that has been set out that's concrete in relation to how decisions will be made within the business, or what happens if you don't agree. And the second component is where one person doesn't want to be in the business, or doesn't want the other person to be in the business. The whole concept of exit just hasn't been clarified and isn't clear. And it's not clear how one person can get out, or how one person can force the other person out. Because the reality is, if you don't have that clearly set out in an agreement, then

you can be in a situation where it's actually extremely difficult to extricate yourself or extricate the other person. So these are the sorts of things that if they're not set up from the beginning, it can be extremely hard to overlay into the future. So I think they're, they're the areas where I see the two biggest issues and I'll dive in sooner, maybe tell you some examples of stuff that I'm saying.

Paolo: We want examples. So I'll make notes as to what we often see as breakdowns because we often unfortunately in terms of valuation side of the business, and half the value businesses for partnership breakups. So like I'm saying partnerships loosely right. It could be a company it can be cross it could be a proper partnership. But you know, these business relationships break out with someone said, Bring on the gory details right?

Joanna: Like a prenup? Yes, sorry.

Paolo: Yeah, It's like having a prenup. And it's like, like a business relationship is actually like a marriage. Because very often, you will spend more time with your business partner in many cases than you will with your spouse. So it is a big thing. So very commonly, what we see issues around is hours worked. So where we have partners that at some point, someone runs out a path and says, Look, I just don't want to work those hours anymore. But I still want to take money. And I still want to collect a wage. So I'm spilling into that. It's like okay, well actually, I want to do more administrative work, I'm sick of being a vet, and I want to do a sales and marketing component of the business. And I don't really want to be, you know, in that in the nuts and bolts veterinary business. And that expectation was never set at the outset. And now suddenly, you know, someone's giving themselves a role in part of the business, which they're not gonna be that good at, you know, but they're sick and tired of the business and they want to sit there in the office and be an administrator because they tired of doing everything else. So this is often where we see some issues. I guess you could probably expand on some of these Jo life stage we have the very young partners with all partners. And the focus, his approach towards risk is very, very different. I think you said you know that kind of your management decisions, you have all the partner who's due to retire in the next three years. You have a bunch of younger partners who you know want to invest in the business and get new software. systems in the new equipment, the other partners thinking, Well, why should I spend on this because, you know, I'm going to exit soon anyway, I just want the money. So you get that last stage based issue where you might need to manage something around sort of hoursworked and decision making around that. And then obviously, the person will be kept incompatibilities in terms of personalities. You know, and I guess there's no agreement that will fix that. But you have to make sure that you have a business partner that you can work with. So those are kind of the the examples. So we can talk about. So if you can give us a real world example of some of that are obviously anonymized.

Joanna: Yeah. And I think what you're talking about here, so there's two elements, aren't they? There's this having aligned expectations in relation to how this business is going to work together. And some of that relates to things that we should including agreements, and some of it just relates to how it is that we going to ensure that we meeting regularly and what are we discussing, and what are we agreeing on all of those sorts of, you know, business management, sort of areas. But then the second point is if you're getting to a stage where it's just not working together, and you know, this is a lot of what we see where it's just not working together. And just as a side note, often

the reason it gets there is because you haven't tackled these First things first, you know, it might be that the relationship was completely salvageable. It's just that you hadn't gotten into getting into the depth of talking about how to resolve these issues, right from the beginning, and having a way to navigate that right from the beginning. And then that leads to, you know, one person feeling really disgruntled and the deterioration of a relationship when it doesn't necessarily have to be that way. And actually, you know, we deal with lots of business partners who come in and who say, you know, it's really strained at the moment, but I don't want it to be strained, but it's just never going to get better. And I look at those situations in almost all of those situations. I think it didn't have to get to that point anyway, to begin with. But I think later, we should talk about why people don't have shareholders agreements. Because the the reason often for this, and when I say shareholders agreements, let's just agree right now that I also am talking about partnership agreements and unitholder agreements. So therefore, we don't have to, like, you know, just assume whatever whatever. Whenever I say shareholders agreements, I mean, all of the others as well, how about that. But the reason that quite often that we don't have them in places because they seem hard to work out what we're going to do in these instances at the beginning, Can I just tell you, it's 20 times harder to navigate these issues, when a dispute when you're not seeing eye to eye than it is right at the beginning. So it looks hard to work out what you do in these situations from the beginning, when you're getting on, I promise you, it will be 20 times harder if you're not getting on. So do it while you're getting on.

Paolo: So my take home message here is actually the 36% of the audience is looking at introducing partners, and 38 of the audience was looking at it. If you cannot have this, recall, a shareholders agreement discussion, before you enter into the into business with this other person, you will not have a functional business relationship. If you can't have cannot have that discussion in the beginning, you certainly not going to be able to iron issues out after. So have if you're buying in or if you're introducing someone into your business, please have that agreement put in place and the discussion around that agreement. So yeah, with that, I'll ask you, because this is a very common one for us is can you in a shareholders agreement, have stated how much input each of the different people has to have in the business? Can you state that they have to work a certain number of hours or do a certain amount of work?

Joanna: Yeah, well, I mean, you can, you can have that. So you can that can be reflected in a number of ways. And that can be reflected in the rights of the other party to trigger a by a buyout of one party shares. So so you can have KPIs in there. So say, for example, you know, you might have things in an agreement that relate to how much you're both agreeing to work in the business. And if you don't, that you then that then that triggers like a default or or a reason for the other party to be able to buy you out? No, no way that that really works, then is for there to be clarity in the agreement about how then the the shares, units, et cetera, et cetera, would be valued in that instance. So that's, that's a super important component. I think, you know, number one, working out whether or not you want to have really hard metrics. So that's an example that you might put in a grant you

Paolo: might say the revenue generated by you might

Joanna: say revenue Yeah. Worked or Yeah, yeah. But but the one issue with that is, you just need to. And this perhaps comes back to a question once again, we'll cover a bit more later on. But the idea of how regularly should you review these agreements,

because that might be what you set from the beginning might be appropriate for right now. But it may not be appropriate as time goes on, then the likelihood is, if you're going to get into that sort of specifics, this is something that you should be reviewing regularly. And I'd say, at least annually, and you know, that just means maybe even just have a checklist of the headline things that you come back to and think about, okay, let's think about what it is that we've put in in to the agreement as the KPIs that we've both agreed to meet, and, and keep coming, or let's have a look, again, at exit or all of those, you know, the key headline issues, because not everything in the shareholders agreement will be relevant to review every year. But there are some things that might be relevant to review. Every now and again, I can see we've got

Paolo: a really good question. So I'll ask it to you because this is I was actually gonna ask something like this. So it's an example of the questions or a list of questions that should be considered both at the start, and on annual review would be hugely helpful. So let's, let's

Joanna: build the annual review. I do you know what, let's, let's, let's try and create a right now, I might want to add to it later on.

Paolo: Yeah, so what sort of things would you be looking at? First, when we get started? Like what questions would you be asking for certain people? And then what would you be reviewing every year? So far away?

Joanna: Yes. Okay. So So what we want to cover now shareholders agreements are decision making, how is it that decisions are made? So what decisions need to be made with everyone agreeing? What decisions can be made, for example, by the majority holders versus the minority holders? And when we say majority, we mean that the holders that you know, have majority of the business? This is

Paolo: a really good one, right? So let's let's actually put this into real world context for everyone. So for example, we have a company with three shareholders. So there's three shareholders now, okay. Which means by the normal company constitution, if you don't have a shareholders agreement in place, two of the shareholders can outvote the third one, okay. Now, for example, two other shareholders, a young vets, the third shareholder is bet who's two years to retirement, the two young vets want to spend a million dollars on a new fitout, it's really not going to be suitable for the guy who's two years, due to retire two years. And at this point, now, they can veto him, or they can say we are going to spend a million dollars on the fitout because we're the majority shareholders, and you just have to wear the load on that until you sell. So how would you catch that? Yeah. Okay. That's scenario in a difficult question. Sure. Yeah,

Joanna: yeah, yeah, no, this is a really good one. Because Because the way that should be dealt with is in the decision making outline, they should be, you know, decisions that relate to capital spends, or any expense greater than x dollars, need to be agreed to by everyone, but but you have to be aware that then if you have a number, lots of owners in the business, then one person can feed out everyone else. And so you just have to be aware, Will that work? For you? Could that be a problem? And if so, then you need a way to break that that dispute, that's, you know, you need a circuit breaker. And the way that generally we'll build that in is triggering a right for the other shareholders to purchase. And then once again, we coming back to making sure you're establishing the right value at that point. Yeah.

Paolo: Yeah. So So yeah, I mean, you said a capital expenditure thing, I see this a lot of agreement, and I think it works. You can say, like, for decisions under $20,000, you go on majority. And for decisions over $20,000, I guess you could agree that all three of those particular shareholders have to agree. Yeah, on an expenditure over a certain amount. And again, this would be on a case by case basis, obviously, might not work for every single, you know, group of shareholders, but certainly in small businesses, like I think exposing a single person to huge economic risk. Yeah, would be would be would be quite risky. And so so in that instance, you know, it might work with there's two young people and one older person, that might be a, a good a good thing to have, if it's three people who are the same age, it might not be, but that's a good example of where we could see potential disputes.

Joanna: Brilliant. Totally agree. Yep, absolutely. So that's the whole decision making. And then and then the other Biggie is exit. So how is it that one party is able to exit if they're and of course someone can just leave a business but you know, how is it that they realize they capitalism? Good business, I guess is the question. So how do you leave? Or how do you move someone else out? If that's and you know, the perspective changes based on whether you're looking at this from a minority holder perspective, or a majority holder perspective. But I can give you so many examples of this is probably the biggest one that comes to us the issue with exit. In fact, we've got one on our desk right at the moment, where we've got a business with four shareholders in it, three of the shareholders want to sell one shareholder, didn't really want to sell, and they decided to put the business to market the business went to market a buy was found. And then right at the end, the one remaining the one shareholder out of the four of them. So the one quarter holder, Newt, the whole deal said, No, I'm not agreeing, and they couldn't sell the business without that person agreeing. Because the buyer wanted the whole box and dice, they didn't want to be in business with this one person that was creating problems. And as an aside, the reason the other three wanted to get out of the business anyway, was because of this one shareholder. And so the problem in that instance, is don't have a shareholders agreement. And there is nothing that they can do to force this other shareholder out. So it's a massive problem. And because of, they then you know, have issues in relation to the running of the business because this person holds this component that they can't extract from them. So that's something that you just really need to think about. And that's when we bring in tricky little things called drag along causes and tag-along clauses,

Paolo: which I was gonna ask you about. So now, so I can, I'll actually have a similar example. Um, it actually isn't in the vaping. Industry, it was actually in the medical industry also. But basically, it was a to two men, business to a shareholders both having 5050 of the business each. And actually, I've heard of this actually more than once, probably about three or four times, and the one guy wants to sell, and the other guy says, Sure, go ahead and sell. But I'm not even going to meet the new person, I'm not even going to be here to speak them. If they want to speak to me, I'm going to refuse to speak to them. And no one is going to buy the business under those actions, right. So the remaining partner can in fact, scupper any sales deal for the exiting partner. Okay, so I understand that. So because no one's gonna want to buy into part of a business where the other half isn't even prepared to speak to them always plenty rude when they're coming in, and it's just rude to them. So the remaining part that in the absence of something to catch this, in a shareholders agreement, or unitholders agreement can actually scupper the deal. So this is actually quite a common scenario

that that you're talking about. And to protect against says these things called drag along clauses and tag-along clauses. So to tell people about drag along clauses,

Joanna: why not? Let's get into the detail? Yes. I'll try not to make it too boring. No, so the drag along? Well, it's quite a, it's quite easy. I like these terms, because they describe what they actually do drag along cause gives the majority holders usually it's the majority holders, the ability to drag along the other shareholders with them on a deal that they've managed to strike. And, and, you know, it's important that we put provisions in there that protect the minority shareholder from, you know, these being some sort of arrangement in order to get their shares off them at some sort of bargain basement price. But, but if all of those things are in place, then it can be a really good clause to ensure that you're not left with a minority shareholders holding on and you're not being able to do anything with their shares or with your own shares, because you can't pull them along. And in fact, I've got an example of that one right now on my desk as well, we've got a client who owns 97% of his business, he's got a 3%, shareholder, 3% shareholder, no, didn't put a shareholders agreement in place when he began 3% shareholders said that they're not prepared to sell, and so he can't get the shares off that 3% shareholder. That's the classic example, where there absolutely should be dragon claws in place. And whilst

Paolo: so just explain the drag along in that case. So the drag along in other words with me that if the majority shareholder decides to sell to a third party, they can drag their 3% shareholder to force them to sell their shares to that same party for the same

Joanna: profit or the same price for the same price. So whatever they're selling the shares for it means that they can sell the whole box and dice of the business. And so but then that whatever deal they've gotten for their shares has to be replicated Exactly. For the other shareholders that have been dragged along, dragged along as in they've been forced to sell their shares at the same price on the same terms.

Paolo: A question on that because I like these reports, and I'm sure that everyone's ears are pricked up on the subject. I know these guys right but are put on So so it's a 60 40% split in the business and the 60% part wanted to sell to say a corporate bit. And the 40% guy is not that happy about having been 60, a minority shareholder will say a corporate that many company. So you say there's a drag along clause in that particular agreement? And can you still have a part of the agreement that says, The first right of refusal, that sell goes to the remaining shareholders, if they are prepared to buy it at the same price as the corporate? And only if they say no to buying it, then do they get dragged along?

Joanna: Yeah, absolutely. You can 100% have that? Yeah, yeah, absolutely. That's,

Paolo: That's what it is, you can actually protect every party can have a very, very fair outcome in that particular scenario. But it's not complicated these agreements get. There's no default agreement that covers this if you don't have it in place. But in this particular case, a 40% shareholder could say, well, actually, no, I'll offer you the same price as said third party. I want the whole practice for myself. And then it gets valued. And then he says, Oh, geez, I actually can't afford that. And then he said, Okay, well, Ben, we will, you've got first rights, but we will sell to the corporate, then you'll be forced to come along with us, however, because the price is pretty good. Obviously, if you can't afford to buy it, it's pretty good. The outcome is might not be ideal, but at

least it's fairly equitable for everyone.

Joanna: Yeah, absolutely. And what you're talking about there, and let's not forget, we'll come back to tag along Next, we haven't forgot about tag-along clauses. But I just thought I'd throw in there. Well, one of the elements that you you're talking about here is what we call pre-emptive rights. I love how we have names for all of these fabulous, how exciting. But pre-emptive rights are something that we generally build into the exit clauses, which effectively says one person can't sell their shares without giving the other person the right to purchase them first, on the same terms that they're offering to sell them to someone else for. And I think that's extremely important to have. And once again, it's something that you only get the right, of, if you have a shareholders agreement.

Paolo: I would see a very little reason not to have that clause in the agreements, because the guy x is still going to get the same amount of money. And it gives the person the remaining parties to the opportunity to purchase that business. So I think that pre emptive clause, I don't know, they've set it out, let's say shouldn't probably be in most of the agreement. Yeah,

Joanna: Absolutely. But here's the trick, isn't it? If there is no shareholders agreement in place, or they've thought about a shareholders agreement, but never signed it? Which happens.

Paolo: Yeah. There's nothing to protect you. What you have is the Corporations Act, which allows the buying and selling of shares, just like on the stock market? So shares could be sold without you even being talked about.

Joanna: Yeah. And that brings in another thing, but we are coming back to tag-along. I promise, I promise but now we're on pre emptive rights. The The other thing, I guess, is the decision about whether or not you want to be able to have a veto right, about a third party that the that the shares are being sold to. So we've got our pre emptive rights, which is the current shareholders get the right to first right, and sometimes first and last right of refusal to purchase. But then there's this other question, you know, should there be some sort of ability of the current shareholders to be able to vet who the purchasers are? So that's another question that, you know, we sort of navigate.

Paolo: Because we've seen what like at recently, and so that that clause, but again, it's on a case by case basis, okay. But in the context of every business, I'm not a big fan of because we have a case on that we've seen recently where, and there is that, that you can't introduce a new partner, unless the remaining partner approves of them. I believe that gives in a veterinary context, because we're looking at businesses that are held maybe by three or four parties that most gives the remaining partners too much power, and they can actually 100% scupper the sale of someone who wants to exit

Joanna: They have to be matched with then what happens if they don't agree? What's our trigger out? Then? You know, and sometimes what that is, is triggering a requirement for the other person to buy or whatever. Yeah,

Paolo: so we're the ones who I've seen this no trigger, there's no oust trigger for for that particular party. So like, either like, I will agree to accept this person as a piping you exit or say no, and there's nothing to allow that partner to exit. So you can see

guys why it's very, very important to get a lawyer to look at these things, by both parties to actually be sat present. And to have that discussion as to is this going to work for us? Because there might be scenarios where it does work for you. But you have to really think about like, is this going to work for us now? And then was the reassessment of the agreement. If you don't have to reassess every three years? You start to think, okay, it worked for us three years ago. Is it still going to work for us and do we want that removed?

Joanna: Yeah,

Paolo: I'm actually gonna with that, I want to launch this poll. Because not everybody is picked up and we've got some gory details I want to see here. I'm going to ask this question here, launch this poll here. And I'm going to ask you guys this. If you are interested for someone else, do you have a business agreement in place? And Please be honest, it's anonymous at the end. Yes. No or you don't know.

Joanna: Just say in case it makes anyone feel better, in terms of considering how they're going to vote here. Do you know what I think 80% of businesses haven't actually finalized. You know, there may have started the shareholders agreement, but haven't finalized. So either don't have a shareholders agreement in place, or have never started or have never finished the process.

Paolo: We've had ones that haven't been signed, it's been in place. But the dirty stuffs come out and outcomes, the shareholders agreement, and no one's signed it. Yeah. So I think the victory industry will actually be better than average on this. But you can see here we having sort of 71% currently saying yes. And 29% saying no, but less than half of you have voted, right.

Joanna: Okay, that's hilarious. I love that.

Paolo: So there is people in place, there is people here that are solid, you can actually share that now. share the results there. We should see this, we can see 71% so roughly 70-30 70% that's guy I love it. But but but a lot of people didn't that's not answered might be don't know. If you haven't answered, I'm gonna see if so there'll be a significant number of people who actually probably don't know, whether or not that is the case.

Joanna: So you know, and that comes back to I think this discussion about how regularly you review it in the importance of pulling out and reviewing it. And, you know, and what the agreement is there for in the first place. Because if you aren't sure, then quite often, that means that even if there is one in place, it's not something that's actually helping to govern the relationship, because it's sitting in the bottom of a drawer somewhere. And when you pull it out, it's likely not to reflect where you are at the moment, which creates a whole heap of problems. Like, for example, just the other day, I was speaking to someone about a particular issue where there are rights built into the shareholders agreement, but they haven't done anything. And there had been a breach and this breach have been persisting for years and years and years, but then pulled the other partner up on this breach. And then if that happens, you've got that problem, which is, you know, have you agreed to basically amend the agreement now, by conduct, which is a thing in law, you know, you can amend agreements by conduct in some instances, which means if someone has breached their obligations under the

agreement, and you've not pulled them up on it, you can have waived your rights to be able to do so in the future, if that makes sense. So it's super important that you understand what's in there, and that that doesn't mean that you have to take action against someone for not complying, but you just need to, you need to have those conversations. And it needs to be clear how you're going to deal with these things moving forward, that your agreement reflects where you are, because the other common issue is we've signed an agreement when we've got two partners in place, but we've brought in a third and fourth at some point in the future. And now the shareholders agreement doesn't reflect where we're actually sitting in terms of..

Paolo: Actually bringing additional people and there's no agreement side, what happens to the existing agreement?

Joanna: Yeah, well, this is a problem. This is a problem, it actually ceases to have real effects. So the shareholders agreement is an agreement between the current shareholders so there are provisions that can stay in place that relate to the current shareholders, but it doesn't bring in the third shareholder, the third shareholder have it hasn't executed the agreement. So in fact, that's one of the worst situations because no one actually knows what obligations are on foot for them at that

Paolo: time. So there's every time you're introducing somebody versus having this review. And just a little joke here, just because I know the audience loves to pull me up on putting my foot in my mouth. Two of them have told me the voting was late because not all of them own a business. Thanks for reminding me guys. Hahaha

Joanna: Yeah. I'd love to ask for those five people. And don't feel you have to put your answers on but maybe a question for you to reflect yourself. For the people who've responded the 71% who say that you do have a business agreement in place. Just reflect yourself. When was the last time you pulled that out? And do you actually know what it says?

Paolo: You don't have to put that in the chat guys?

Joanna: Yeah, no, that's just to reflect on it. I'm actually one thing we didn't answer tag-along. So let's come back to tag-along.

Paolo: Drag along where you can drag someone out. Now Jo's gonna speak about tag-along clauses.

Joanna: Yeah, so a tag-along clause is where one party so in this case, it's usually the minority Party, but it can, it can be the case for any party has the right to tag along with the party that's selling A they have the right to require that if another party sells that they ensure that the buyer offers them the same deal that they're offering their other partner, if that makes sense. So it's the ability of them to tag along with the sale, if they want to be part of a sale that is being processed by their business partner, as opposed to the drag-along, which is giving the selling party the ability to drag the other party with them.

Paolo: So I like to tag along clauses just to put put into context of the vetinary example I gave earlier. There's a 40% shareholder and a 60%, shareholder, the 60% shareholder wants to sell out to big corporate, the 40% shareholder is not convinced

they want to carry on working there as a minority shareholder under a big entity that they're not familiar with. So if there's a tag-along clause, what happens is they have, they can say, Well, okay, Mr. Corporate, or whatever, you're buying 60 shares for a certain amount of money at 40% shares, you are forced to buy for the same amount of money, and you will own 100% of the business. And I actually like tag-alongs for that, because it gives the remaining partner an equitable way of exiting the business without finding them stuck with an unknown, with an unknown entity or person. So you know, it's kind of like the tag-along, it's not a one size fits all. But I like what the tag-along does, much preferred, for example, to the, you know, allowing the remaining partner to stop the deal, I think it's almost scary to have a tag along with a can sec, I'm not gonna, I can't stop with you, but I can at least get the same amount of money, I can choose to carry on working with the new guy, or if I don't like, I don't think I'm gonna like it, I can exit at least at a decent price. So that's the tag-along. So that's, that's what causes.

Joanna: So we finally got there and rounded it out. We have so many things to tell you about. It's hard to keep on track. Maybe, maybe if I throw in a few other things here about what these agreements cover. So we talked about the decision making and the exit, and some other things our capital contribution. So if you decide that there's capital, that you're going to require, you know, the parties to put in funding, you know, that's something that should be said. And sometimes it's really important to set out a distribution policy, because sometimes, you know, there's differing positions on how much of the profit should be distributed versus retaining the business as working capital or for growth.

Paolo: So you could, for example, when I was talking about hours worked, and it say, for example, and correct me if I'm wrong, because I'm just doing the top my head, right, and I'm not a lawyer. But if you have a shareholder 5050 shareholders agreement, and no shareholder company, and there's no agreement in place, it's quite like and they're both working in the business, but one of them decides they want to cut back their hours to half maybe working 20 hours a week, but still want to collect a full time wage. How would that work? If there's, you know, how can you do that? Can they continue taking our higher wage? Or, you know,

Joanna: yeah, exactly. And this is a problem, because, you know, the decisions that have to be made by the business are, you know, have to be made by agreement of both parties we're in, you're in a 5050, because in a 5050 setting, you need to get a word in the absence of any shareholders agreements or any other agreement in place, you have to have both of you agreeing to everything before any decision can be made. So you can see that it can create deadlocks, it can create a nightmare if you haven't, if you haven't, you know, established the parameters of how you're going to make these decisions. And one of the things is you don't need to set out. You know, we talked before about having KPIs and those sorts of things as triggers for default, and allowing for buyback of shares and all of those sorts of things. But you don't need to set out that sort of detail in the shareholders agreement. It can be something where you can refer to an annual budget, for example, or an annual plan that you're putting together, where you set these out together by agreement each year. And if you don't agree, then it reverts to the previous year. And that's also a good way to deal with expenses that you're looking at occurring, because we talked about this whole question of you, you know, you know, the size of expenses. So when you're entering into this agreement, you might decide that you're going to start out by agreeing on a business plan or a

budget for for the next 12 months, and that you'll revise that every 12 months so that you've pre agreed on it. Because sometimes, you know, it might make sense if one person is responsible for going and dealing with the administration side of the business or entering into certain contracts. And it just might not be practical for you to have to come back to the table and keep agreeing on all of these things over and over again. So You can deal with that without having to get really detailed in the agreement itself by referring to the sort of annual plan or annual budget or whatever you talking about. So that's a really good method, I think, that I've seen work really well in practice for navigating some of those issues. And as I say, if you're in that 50-50, sort of scenario, I think in a shotgun closes, you know, you need to deal with exit. If it's not getting along, you can't make decisions moving forward, but highlighting what area each sort of partner is responsible for in the business, and then setting up those annual plans, and then having this sort of position that you review it annually. But if you don't agree, then you just stick with the prior. And your plan, I think is a really good way to go.

Paolo: That's a good idea. I'd never thought of that as actually having a pre planned budget and then limiting the expenses, not by a certain cap, but actually, yeah, pre planning the year, which every business owner should do, but lots don't. Yeah, they say, Okay, well, this is going to be our expense allowances. And if we want to go over them, then we jointly have to agree. Yeah, and I think that's definitely good, because I've always been worried about 5050. Shareholders or partnerships, where there's deadlock, and no one can make the decision. Yeah. So that's actually a really good way around it. So that's very, very useful. It's really…

Joanna: ..practical, it works really well, in practice, I can say it's

Paolo: Probably a bit obvious job. But in terms of the thing, other things agreement should cover, I guess, is not when is when things happen that the associate parties have got no control over. So in the absence of a shareholders agreement, what happens if you have a 5050 shareholder business, and one of the shareholders dies in a motor vehicle accident?

Joanna: Yeah, and this is terrible, nervous, like thinking about this sort of stuff. But this is so important. So your shareholders agreements can deal with, you know, they can be we call them by sell provisions within the agreement that that relate, and usually, there'll be some connection to insurance. So it can be the case where you can build in this disability for the other partners to have insurance if they've to be funded by insurance to buy out the shares or the beneficial component of the partner that's passed away. So that's one way of dealing with it. Because one of one of the risks is that if you're in, you know, a business, like a veterinary practice, which relies on everyone putting in certain effort, and then something has happened to one of those partners, and the estate of that partner becomes the partner in the business now, but are not contributing to the business itself, it can feel like an inequitable position, but it can also be difficult. For you know, it's a lot of concern for people, what rights their estate will have, or their beneficiaries of their estate will have, in terms of being able to liquidate the value in their business as well. So it really it that works, you know, for both parties, I think,

Paolo: correct me if I'm wrong, but under, in the absence of an agreement between the parties, the shares would get treated as they would shares on the stock market. And potentially, if one of the say you're getting on gangbusters with your business

partner, he does the car accident, has no immediate family, and you can potentially find yourself in a 50-50% partnership with his cousin who's a broker. And that, that cousin might say, if you don't have the necessary clauses in place, I actually really liked being part of the safety business, I don't have to work any hours and the you know, the distributions and dividends feed by drug habits. Yeah. I'm not joking, this can happen, right? That you've drawn to have something in place that to deals with death of a shareholder partner, permanent disability of any one of those parties. And normally that's covered by insurance, which the equitable thing around that is, it covers in now for the remaining people to purchase the shares in the in the injured or deceased persons part of the business, and their family actually gets the money and not the business, which I think is actually the fairest outcome, in my opinion, you really need one of those clauses in place. For those of you who don't have an agreement in place that is high risk, even if you think we're getting on gangbusters, we have no problems and we discuss everything. There's the inevitable that can happen. And we've seen, unfortunately, the vapor industry a couple of cases of permanent disability happen, particularly in large animal vets or bets traveling to farm visits and hitting kangaroos and having terrible car accidents and things like that it happens so be aware of that.

Joanna: And actually, the other thing that I want to throw in there is importance of restraints because if you don't have an agreement in place there is actually very little that you can practically do to stop one party from operating in competition perhaps with with the business. So, you know, that's something to think about shareholders agreements, we usually have a restraint, something that says, Well, you know, none of us can, you know, compete with the business. Well, during the period that were a shareholder and, and for x period afterwards as well, that can be quite a useful clause, but you just have to be careful about the application of that. Because if you're not happy with how the business is running, and you've got no way to get out, you also potentially have an issue in relation to what else you can do outside of the business. So it's important that that the way this is applied is thought through carefully.

Paolo: Yeah, yeah, I agree with you that often when we see restraints, or traders, I would say it's very fair to have a restraint of trade, whilst that person owns shares or as part of that business, you know, they shouldn't really be allowed to open up in competition with their fellow shareholders. But then once they sell the business, often the restraint of trade gets added into the sale agreement doesn't we often see that? Yeah, it may not because you may not have control as to what the sale agreement is, if you remain in but very often a restraint of trade is often like a lack of a certain number of kilometers is, is applied to the to the sale of the business. So when they are exiting, but I don't know if I've commonly seen restraints of trade, like already present in the NDA agreement, prior to the sale. But I can see why why it would be useful in some cases and not in others.

Joanna: Yeah, that's right. So probably about half of the shareholders agreements that we deal with will have restraints that survive past termination foot for a set period of time. But there can be a whole heap of reasons for that. But as I say, and as you're talking about, he has to be really careful about you know, whether that's appropriate, and it's about making sure you've, you're going into this with your eyes wide open and understanding what's in these.

Paolo: This is one of those ones where you'd all have to sit down together before you go into business and agree on because as Jay said, 50%, yes, 50%. Now, you might

collectively say Actually, no, this is too risky for us, we don't want this restraint. Or you might all agree, yes, we do want this restraint, then maybe three years down the track, you might change your minds, which is why you have to have to create

Joanna: a rod. One quick word on restraints, because I find people quite often get a bit confused about restraints. First thing. People often think that restraints are not enforceable, because there's this sort of theory that goes about, but they are absolutely enforceable in a shareholders agreement context. So you have to, you know, be careful about your thoughts in relation to that. But restraints can be two things, it can be non competition, so not competing, and it can be non solicitation, ie not taking staff not taking clients. So there's two different things that you have to consider with restraints and they should be dealt with separately. But generally speaking, if you don't understand the difference, you may not know to look out for that.

Paolo: Let's see, that's something. So look, we're getting to sort of we're going to be doing this for an hour going everyone still here. So obviously, I made myself cheat at night. And I think we've covered most of the things, just I made some notes on these the common scenarios of breakdowns, but I think we've covered most of them, you know, an equal sort of revenue generation, the holidays, things like that. last stage, I've talked about younger partners with all the partners we've talked about that this is one that can happen, just as a warning to you guys is when you initially do an agreement, like everyone's at a certain stage in their life. But then, you know, maybe the three or four way partnerships, suddenly changes in home life happened to one of the one of the shareholders. And that might be you know, they suddenly have children I had a case this was before was the capital, I used to like a couple who had accidentally had triplets, right. And suddenly changes, right things change, all of a sudden, you know, this marriage issues, there's divorces, these are things that are outside of the context of the business, but can certainly affect one of the shareholders performances, and this is things we've, we've seen happen, and you can see suddenly, where you know, allowing them to exit more easily might be favorable, giving them an equitable exit point might be quite favorable, where you might have, you know, the first option to purchase their shares is very favorable, Joe, and this again, I was actually gonna highlight on this again, because we've mentioned this is, you know, when someone has to exit the business was nice to exit the business has to be valued in some shape or form. And you have to deal with how the value of that business is going to be established when these sort of things happen. So I'm not trying to sort of, you know, be a cheerleader for our valuation business. You can get a what I would suggest you do is you probably have a valuation done by two values if that's okay. If you can agree on having One value, it's cheaper for everyone. But there's also I've also seen in business agreements where, where the actual way the business is going to be valued this preset by a set number of KPIs and rules. And that makes the exit very, very easy. Yeah, it does have the disadvantage, though, that in the one I have seen, the business was very undervalued because that formula had been applied, you know, maybe five or six years or 10 years prior, and the industry had boomed quite a lot on the way. So the equity partner got a lot less than they should have.

Joanna: For regular review isn't to call

Paolo: Out for regular review. But you've got to understand that the business valuation or way to establish what this business is worth is going to be critical to the exit issue of like, say, a divorce or sudden lifestyle change of a particular partner. It doesn't have to

be injury, it can be triplets. So that actually covered everything. So those are the only other scenarios that I've seen them really causing major partnership issues, and then the ones that Jo's just dealt with.

Joanna: Well, that's it for this episode of Talking Law, I hope you found the information that we covered today useful and relevant for you. And certainly, it's something that you should be considering if you're either considering going into business with someone else, or indeed, if you are already in business with someone else. Now, if you'd like more information about this topic, then just head over to our website at talkinglaw.com.au where you'll be able to download a transcript of this podcast episode if you would love to read it in more detail. Now, a little bit of a warning here. Our transcripts are automatically transcribed due to the amazing abilities of AI however, it's not perfect, so please don't expect to read a Word Perfect transcript. It's the computers in the skies attempt at getting at getting these words right. But anyway, it's almost perfect but just not absolutely perfect. On our website, of course, you'll also find details of how to contact Paolo, if you have a veterinary practice that you would like some consultation in relation to or indeed if you're looking at heading into a sale, or perhaps looking to acquire a veterinary practice and you'd like to organize valuation for that business, then check out our show notes for links straight through to value vet who are absolute specialists in this field. Now on our website, you will also find details of how to contact our legal Eagles at Aspect Legal If you or your clients would like to discuss any legal aspects of sales or acquisitions. We've got a number of great services for businesses in sales, right acquisitions and also a number of great services obviously in helping you arrive at your shareholders agreements. Well, that's it I hope you enjoyed what you heard today. If you did then please pop over to iTunes and make sure you hit that subscribe button so that we can be delivered to your year on a weekly basis. And of course, don't forget to shoot us a review via iTunes or your favorite podcast player if you like what you heard. Well that's it. Thanks again for listening in. You've been listening to Joanna okie and Talking Law, a podcast proudly brought to you by our commercial legal practice Aspect Legal. See you next time.