

CASE STUDY

Background

Softdrink Ltd. is a UK firm which makes and sells various bottled non-alcoholic beverages, both carbonated and non-carbonated. These include flavored fruit drinks, colas, ades and teas which are prepared under proprietary formulas created and owned by Softdrink, bottled and labeled on the premises, and sold to distributors in the UK under the company's various trademarks such as "Colony Cola", "WindsorAde" and others.

Softdrink owns a natural spring which is sourced on its property in England and fed into its mixing and bottling plant on the same property. The entire water supply from this spring is utilized in the production of the other beverages, and is in fact supplemented by water purchases from independent third party sources in Great Britain. As the beverage business grows, these outside water sources become more important to Softdrink. Because of this increased utilization by the company as well as the rising demand for natural spring water generally, the prices for this raw material have steadily increased and, together with increased distribution expenses, the company has legitimate concern for its longer term profitability. Several reputable hydrologists have studied the company's natural spring and have concluded that its output cannot be increased in any meaningful way without jeopardizing the entire source itself.

Softdrink is a "private" company, that is, it is a UK corporation with a limited number of shares and shareholders, all from the same family, who hold their shares under a Shareholders' Agreement with restrictive provisions including restraints on the selling of shares. (This type of company is to be distinguished from a "public" company, that is, a company with many shareholders who are free to sell their shares into the public markets generally through Stock Exchanges.) Softdrink's total capital consists of 1000 ordinary shares all of which have been issued. The major shareholder and Chief Executive Officer is the 65 year old patriarch of the family, Sir William Dreadnaught, who holds 52% of those shares. His six children, consisting of three men and three women, are all working in the business in various executive capacities, and each owns 8% or 80 shares. Sir William's eldest son Peter, 44, is the President and Chief Operating Officer, and is considered the most likely to succeed his father as CEO when the time comes.

Sir William has run the company conservatively, funding its growth internally from its own considerable earnings. For many years the company borrowed no money from outside sources, but in the last few years the company has taken on modest debt from local banks (equal to about 10% of its equity), and the family is concerned that additional borrowings may be required in the future, particularly since it would like to penetrate international markets by exporting the products.

Interest in Botswana

Having exhausted the possibilities in the UK, Peter Dreadnaught had been searching the globe for another, lower cost water supply when the Botswana Embassy in London advised him of a 10,000 hectare tract of land owned by the Republic of Botswana and containing large natural springs. The land lies north

northeast of Maum and just south of Chobe National Park border. It is a remote area of the country, not accessible by paved roads or serviced by utilities.

Peter has examined the springs with a hydrologist and is convinced that the water volume is many times that of Softdrink's source in the UK and is of the highest quality. The Botswana government is of course interested in the development of this property provided it would provide employment and earn foreign exchange. It is not prepared, however, to itself invest the large sums needed to develop the property. A better plan is needed whereby the Government can provide the land as its sole non-cash investment, and still somehow participate in future profits.

Peter understands the government's point of view. He also realizes that Softdrink cannot itself provide the funds needed to develop the property and the required infrastructure. Peter concludes that a business collaboration of some sort must be designed to fairly serve the interests of each party. Other local entities no doubt will also have to be brought into the picture to provide financing for the project, and this financing can take the form of debt, equity, or a combination of both. Just as the creation of this multi-party collaboration is a key ingredient to its ultimate success, equal thought must also be given to the possibility of the desire of some of the parties to disengage from the project in the future. In other words, Peter recognizes that an "exit strategy" may be just as important to consider as the "entry strategy" even though none of the parties at this point foresee the day that this might happen.

In the programme, you will be asked to assume that you have been engaged to represent Peter and his Company, the Government, or local sources of capital. Thus, in thinking through the issues presented here, we will first need to understand the client's business objectives, and then identify each legal issue required to be addressed in order to reach those objectives. With each legal issue, we will discuss the documentation required as well as the drafting and interpretation of those documents.

These legal issues will include consideration of the following:

- corporate and partnership law,
- corporate finance, debt and equity instruments,
- purchase and sale agreements,
- fundamentals of the capital markets,
- tax law and regulatory authorities of the Botswana government
- real estate transactions,
- trademark law
- contracts, e.g., supply, distribution and services agreements
- other issues as may arise under the laws of Botswana.

SESSION SUMMARIES

1 Session 1: Introduction; Forms of Business; Understanding Financial Statements [Kevin Salisbury]

1.1 *Background:* The programme will emphasize the following principles underlying the practice of commercial law:

- A. **RISK.** At the center of most business deals is **risk**. Helping the client identify and understand these risks so that the client (not the lawyer) can make an informed business decision is a hallmark of legal business practice. After identifying risk, there may be the opportunity to limit the risk, allocate the risk among business parties or to shift it to third parties. Understanding risk provides a better understanding of due diligence, legal opinions, fairness opinions, indemnification, etc. The concept of risk also provides a convenient way to talk about transaction costs, an issue of great importance to middle market clients who may be embarking on a once in a lifetime transaction and therefore have little appreciation of what effort may have to go into even a single transaction document.
- B. **DOCUMENTATION.** The importance of properly documenting the transaction is not as a housekeeping measure but as an integral part of enforcing the agreements articulated in the transaction documents. Proper documentation also plays a key role in protecting the lawyer and his or her partners from malpractice claims and as a way of developing follow on business.
- C. **WHO IS THE CLIENT AND THE PROPER ROLE OF THE LAWYER.** This can be a particularly confusing and vexing problem for lawyers representing middle market clients in general and for younger lawyers, in particular. Since facts and players are more likely to change in middle market and private transactions than in institutional transactions, the lawyer needs to constantly ask these questions and adopt strategies to deal with the situation. Regardless of the client's size, the lawyers must know the details of the client's business and tailor his or her advice accordingly. That is, the commercial lawyer is an advisor, and not simply a document drafter.
- D. **WHAT IS MY CLIENT'S LEVERAGE.** There is a dramatic difference in how litigation attorneys think about leverage and how business lawyers should think about it. Understanding leverage in each transaction and the risk profile of your client and adversary is fundamental to proper representation. Sometimes the client has no leverage at all and merely needs to know what the legal instrument they are about to sign says. Other times, leverage will present the opportunity to seek modification of a limited number of terms and so prioritization of terms becomes critical. Taking account of a client's leverage in the context of shareholder

agreements, leases, loan agreements, etc. will emphasize how this issue is key to representing commercial transactions.

1.2 Session Outline:

This session will focus on the question of what form of entity you should consider for Peter to operate his Softdrink business in Botswana and what the advantages and disadvantages are in using the different types of business organizations, e.g., private company vs. partnership.

We will also discuss the tax and monetary impact on individuals of forming an entity. The following issues often arise: (i) double taxation, (ii) avoidance of, or minimizing, double taxation to the extent permitted under Botswana's revenue laws depending upon what type of entity is chosen, (iii) fees based upon annual income, but separate from income tax, which may be imposed of particular types of entities, and (iv) the costs of forming and maintaining an entity. You do not need to learn the answers to all of these questions; however, you do need to know when to consider about these questions, and when to consult with an accountant or tax counsel regarding such questions.

We will also address Accounting for the company's capital on the financial statements as well as the overall purposes of the balance sheet, income and cash flow statements, and how the commercial lawyer will utilize these tools in due diligence, document creation and negotiations. We will discuss accounting concepts, such as (1) working capital, and (2) valuations of a business – and the notion of multiples, cash flow vs. EBITDA and DCF.

1.3 Delegate Activity:

After the session, draft a short memorandum recommending what form of business entity Peter should use to organize his Softdrink business in Botswana and why?

2 Session 2: Capitalization; Shareholder Agreements [Kevin Salisbury]

2.1 The session will focus on the basic principles of equity and debt financing and the typical expectations of their respective holders, a general review of basic corporate finance, defining and illustrating the typical financial instruments used to “fund” or “capitalize” a company.

Next, the rights of the Company, as well as the rights of shareholders (equity holders) and creditors (holders of the company's indebtedness) will be examined. We will discuss the opportunities for improving the ordering of a Company's affairs by using a written shareholders agreement. We will discuss how the shareholders agreement might be used as a guide book for such issues as (i) how communications among the shareholders and the company are to handled; (ii) how and when shareholders may participate, or

are not permitted to participate, in the conduct of the Company's business; (iii) how Company profits and losses are allocated and funds distributed; (iv) whether, and under what circumstances, the Company might want protection from actions of its shareholders outside the Company; (v) how disputes among the shareholders are to be handled; and (vi) what exit strategies are available to the shareholders.

2.2 Delegate Activity:

After the session, review the case study and list what steps you recommend should be taken to creating a viable capital structure for the Peter's business in Botswana that it can meet its objectives.

3 Session 3: Loan Agreements; Real Estate Agreements [Kevin Salisbury/Gwen Johnson]

3.1 Session Summary:

This session involves the interplay between complex legal, business market and strategic concerns.

A. Loan Agreements.

We will begin the session with a discussion about what a commercial bank is and what it is not. We will talk very generally about the loan officer, the loan review committee and the reality of form documents. We will then move on to talk about the central premise of a commercial loan and the role risk plays in the bank's decision to make the loan and how the bank prices the use of its money in accordance with that risk. A word here will be added about pre-payment penalties. We will also talk about how the bank seeks to protect itself generally by discovering risk factors and changes in those risk factors during the course of the loan.

We will talk about disclosing and reporting on risk factors through (i) the due diligence process; (ii) representations and warranties; and (iii) affirmative and negative covenants. We will also consider (i) change of control provisions; (ii) events of defaults and cure periods; (iii) suretyships and guarantees and (iv) bank's options on default. After reviewing these provisions and how and are they likely to play out in the real world, we will tarry a moment on financial ratios as part of the covenants and relate back to the financial statements discussed in the previous session.

We will next talk about the concept of security, including different types of security ranging from tangible to intangible. In the process, we will look back to the financial statement and discuss why the tangible property appears there but the intangible does not. We will also talk about the concept of after acquired property falling into the collateral pool.

We will also discuss the following terms and conditions typically found in a commercial loan agreement:

- Loan Amount and Interest Rate
- Interest and Capital repayment date
- Use of proceeds
- Warranties & Representations
- Covenants
- Information requirements
- Security required
- Events of Default

B. Commercial Lease and Purchase Agreements.

We will also briefly review commercial leasing and real estate purchase agreements.

A Lease Agreement is a legal instrument documenting the relationship between the owner of real property and a person or entity that wants to rent all or a portion of such property. We will examine the basic provisions of a commercial lease for the type of property that Peter's business might consider renting. Some of the lease issues we will consider are:

- Lease Economics (Rent and more)
- Commencement Date versus Occupancy Date
- Tenant Improvements
- Term of the Lease (including renewals and options)
- Representations of Landlord (if any)
- Ongoing duties (if any) of Landlord during Lease term
- Ongoing duties (the many) of Tenant during the Lease term
- What happens if the business fails? The Landlord's "wants" and the Tenant's "wants"
- Lease Termination

A Purchase Agreement is a legal instrument documenting the terms of purchase and sale of real property. Our discussion will focus on the sections of a real property purchase agreement which are at the heart of a conveyancing transaction.

3.2 Delegate Activity:

After the session, assuming you represented a Bank approached by Peter for a commercial loan to fund his Softdrink operations in Botswana, list the principal questions you would have and information you would want supplied.

4 Session 4: Other Agreements [Kevin Salisbury/Dave Williams]

4.1 Session Summary:

This session will provide an overview of other types of commercial contracts that could help Peter operate the business in Botswana.

We will first discuss a Product Purchase and Sales Agreement which is a legal document formalizing the relationship between a buyer and a seller of a product. The purpose of a Sales Agreement is to assist businesses with the formalization of rights and obligations when selling or purchasing a product. Typical provisions of a Product Purchase and Sale Agreement are as follows -

- Definitions
- Parties
- Price
- Terms
- Effective take-over date
- Risk and delivery
- Warranties
- Details of product sold
- Price adjustments
- Proof of purchase

[What about Distributorship & Franchise?]

We will also review employment and other service contracts, including how these contracts are used to regulate rights during employment and to govern an employee's behavior after employment has ended. We will discuss how employment contracts can limit the ways in which an employee may use confidential or proprietary employer information, or restrict the employee's right to compete with the employer. We will discuss the scope of non-compete agreements, and considerations of the geographic area covered or the length of time that it lasts.

5 Session 5: Governance: [Kevin Salisbury/Gwen Johnson]

5.1 Session Summary:

This session will focus on the legal as well as practical aspects of a communication and governance regime in the corporate setting.

We will first introduce the concept of fiduciary duties as one of the range of duties that might be owed by one to another in the context of Peter's business. We will discuss the duties of a (i) shareholder to other shareholders including a majority shareholder to a minority shareholder; (ii) director to the corporation, shareholders, creditors and other directors; (iii) lender to the corporation; (iv) others via contractual or moral commitments.

We will focus attention on the legal significance of the different governing documents impacting the corporation, establishing the concept of primacy of statutory law, the company's charter, its By-laws, Articles of Association, resolutions adopted by directors and/or shareholders, agreements among shareholders and agreements between the corporation and third parties both now and in the future (i.e., banks, the JSE, etc.).

We will discuss what is a dividend and how the declaration and payment of dividends fit into the business life of a corporation and the concerns of its investors and lenders. Included in this discussion will be any legal requirements or limitations on the payment of dividends imposed by South African law.

Finally, we will discuss how internal corporate governance and transparency issues interact with several types of government regulations. The impact of these regulations vary by the type of business involved but frequently include the following -

- Competition Law
- Environmental and Public Health Protection
- Employee and Labour Rights
- Consumer Protection
- Zoning and Land Use
- International Trade
- Currency Conversion & Export Rules
- Taxation

These regulatory topics will not be covered in depth in this programme. The successful commercial lawyer does not need to be a master of all of these topics, but must know when the client's interests are implicated by governmental regulations and when to seek guidance from a specialist.

6 Session 6: Contract Negotiation [Perry Irvine/Steve Spronz/Dave Williams]

6.1 Session Summary:

[TBD]

7 Session 7: Contract Drafting Workshop [Perry Irvine/Blair Duncan /Dave Williams]

7.1 Session Summary:

[TBD]

This session will consider the elements of effective commercial contract negotiation including determining the objectives; preparing for a negotiation; developing an appropriate strategy; organization; methods of achieving the objectives; and the effect of different personality types on the negotiation process.

8 Session 8: Negotiation Workshop I [Irvine/Duncan]

8.1 Session Summary:

[TBD]

8.2 Delegate Activity:

9 Session 9: Negotiation Workshop II [Jim St. Clair/Irvine]

9.1 Session Summary:

[TBD]

10 Session 10: Enterprise Sale I [St. Clair/Bookbinder]

10.1 Session Summary:

This session will consider the initial phases of a sale of an enterprise, including -

1. Determining the intent of the parties;
2. Recording that intent in a letter of intent or term sheet, with a discussion of the purpose of an LOI or term sheet; and the typical contents including both binding and non-binding provisions;
3. Protecting confidential information and relationships with employees and customers during due diligence, with a discussion of the principal terms of a confidentiality agreement and the different perspective of the buyer and sellers;
4. The use of exclusivity and “no shop” provisions (either as separate agreements or placed in the Confidentiality Agreement);

5. Due diligence with a discussion of the types of diligence (physical, financial, management and legal); why lawyers do legal due diligence; the relationships between due diligence and the representations and warranties in the agreement; and how to do due diligence; and
6. The diligence report for the client

10.2 Delegate Activity:

After the session: Draft what you believe to be the essential provisions of a term sheet or letter of intent if Peter decides to sell his Botswana business to a South African company. Consider in particular: (i) what the structure of the transaction should be (shares, assets); (ii) what the structure of the purchase price should be (eg., cash, cash and note, earn-out); and (iii) what should be done to protect the lenders and the government

11 Session 11: Enterprise Sale II [St. Clair/Bookbinder]

11.1 Session Summary:

This session will consider:

1. The commercial lawyer's role in assisting his or her client to understand and manage the risks inherent in the purchase or sale of a business enterprise. We will consider the use of representations and warranties and due diligence to confirm information and to allocate risk.
2. The consents and approvals needed to close the transaction: "internal" approvals (directors and possibly shareholders) and "external" approvals: regulatory, contract parties, creditors, employees.
3. The mechanics and documentation to transfer ownership of the enterprise.
4. The provisions of a typical purchase and sale agreement, and how they relate to the foregoing.