Redistributing Share Capital

Considerations for family-owned enterprises

Virtual Round Table Series

Commercial Working Group 2019

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Considerations for family-owned enterprises

According to the World Bank, there are more than 160 million privately-owned small and medium-sized enterprises in the world employing more than 500 million people.

Many of these businesses are family-owned, with tightly held shareholdings. They are very often well-established companies where control has been maintained by a small of group of individuals since inception.

In an increasingly demanding economic environment there are a myriad of new challenges facing family-owned business models, ranging from the threat of advancing technology to succession planning for younger generations with different aspirations than their parents.

Opening up share capital to third parties is often a difficult, but necessary step to free up capital for investment, or to offer incentives to existing employees. It may also be done in order to attract talented individuals as part of a succession plan, or to lock in reliable suppliers or customers. Releasing value for owners, or generational estate and tax planning are other reasons.

According to a 2019 survey of US family businesses, conducted by an international consultancy firm; 47 per cent of firms surveyed are planning to bring in outside expertise to help them run their company, while 39 per cent expect to merge with another company within the next two years. More than a third of firm's said they were open to bringing in private equity (PE) to help fund their business and the report noted that PE houses are renewing their focus on the family-business sector, carving out specialist teams to do this.

Whatever the reasons for restructuring the share capital, there are different challenges and dangers that need to be assessed thoroughly before any action is taken.

Chief among these is loss of control. Negotiating with a private equity funder is very different to dealing with another family member, and will require much more attention to detail in order to ensure that too much is not given away in exchange for an injection of cash.

On their part, potential investors will attempt to maximise control in exchange for their investment. A highly-negotiated transaction might include mandatory dividend distribution rights, or the essential veto rights on decision-making. It could also have clawbacks or provisions that would entitle them to increase their ownership in the event that certain performance criteria or thresholds are not satisfied.

Examples of ways to mitigate loss of control, include the use of a shareholders' agreements, or the sale of different classes of shares without voting rights. Clauses that guard against some of the issues above would be recommended. With regard to restructuring for succession planning, vehicles such as trusts can be used to transfer value while mitigating tax.

While it is clear that many privately and family-held enterprises must open their share capital in order to achieve their goals, many owners don't fully understand the risks inherent in doing this. Without proper advice and guidance, it could lead to major strategic decisions being vetoed by new shareholders, or worse, a total loss of control of the business.

The following feature draws upon the expertise of ten professionals with significant experience of helping privately-owned enterprises to restructure their share capital. These experts share the benefit of their wisdom around the reasons for restructuring, the risk involved and why using an advisor is crucial.

The View from IR

Thomas Wheeler

Founder

Our Virtual Series publications bring together a number of the network's members to discuss a different practice area-related topic. The participants share their expertise and offer a unique perspective from the jurisdiction they operate in.

This initiative highlights the emphasis we place on collaboration within the IR Global community and the need for effective knowledge sharing.

Each discussion features just one representative per jurisdiction, with the subject matter chosen by the steering committee of the relevant working group. The goal is to provide insight into challenges and opportunities identified by specialist practitioners.

We firmly believe the power of a global network comes from sharing ideas and expertise, enabling our members to better serve their clients' international needs.

MEXICO

John R. Colter-Carswell

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John R. Colter-Carswell has been practicing law in Mexico for more than 20 years, coordinating legal activities with outside law firms. Has been the legal department manager for certain Mexican conglomerates such as Grupo Pulsar, S.A. de C.V. and Fabricas Orion, S.A. de C.V., where he became involved in a variety of domestic and international legal aspects with respect to business transactions.

Has is a respected and well connected leader among legal, corporate, and government institutions and associations throughout the region, such as the Maquiladora Industry Association, local industrial chambers of industry and commerce, Federal and State Commerce Department and foreign investment governmental agencies.

BRAZIL

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Lavinia has more than 20 years of experience as a lawyer, advising financial institutions and companies, while structuring and implementing financial transactions in Brazil and abroad, including regulatory and tax issues.

She acts as senior counsel to Brazilian multi-national companies, and has extensive experience with legal issues related to the Brazilian financial market, including the Brazilian Central Bank foreign exchange regulations, tax and regulatory advice for financial institutions, and assistance to international banks to structure and set up their Brazilian operations.

She is also Professor at IBMEC in São Paulo on the Specialization Program on Planning and Financial Markets Gestax/IBMEC and the Preparation of Master in Tax Management Program.

GERMANY

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Dr Markus Steinmetz has worked for Endemann Schmidt since 2014 and was a founding member of the firm.

He studied law at the universities of Trier and Munich, achieving his MBA from the FernUniversitat in Hagen. He was awarded a scholarship by the German National Merit Foundation (Studienstiftung des deutschen Volkes) and is an Assistant Professor at LMU Munich (Prof. Dr. Lorenz Fastrich)

He began his legal career with Linklaters, working as an attorney in Shanghai and Munich, before moving to SEUFERT RECHTSANWÄLTE. He became a partner with Endemann Schmidt in 2017.

He is a licensed specialist for corporate and commercial law, focusing on M&A, Commercial and Corporate Law, Private Equity, Venture Capital, Bankruptcy and Liquidation and Labour Law, specifically Works Council Constitution Law.

ENGLAND

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Alex specialises in co-ordinating, structuring and advising on corporate transactions and regularly advises clients based in both the United Kingdom and internationally on mergers and acquisitions, joint ventures, restructurings and corporate re-organisations.

A solicitor qualified admitted to the Supreme Court of England & Wales, Alex offers pragmatic and commercial solutions to clients both looking to invest in the United Kingdom or to export their services or expand into new territories around the globe.

Recent work includes, advising on an investment of in excess of GBP 5,000,000 in a private renewable energy initiative, negotiating favourable secured protections for a junior lender.

Advising senior stakeholders on the issue of further loan note securities to raise finance for a major acquisition in the financial services sector.

Advising banks and private lenders on structured and tiered debt solution, and drafting and negotiating inter-creditor arrangements and deed of priority/subordination.

FRANCE

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Bruno Pichard is a former student of the Ecole Polytechnique and of the Institut d'Etudes Politiques de Paris. He holds a Master's degree in law (DESS) and is admitted to the Hauts-de-Seine bar. He has gained precious experience from his very rich and varied education.

In addition to his experience at the bar, he has been a lecturer at the Institut d'Etudes Politiques de Paris and at Ecole Polytechnique. He has also been a member of the Bar Council.

Before joining the firm Pichard et Associés, he was a Commissioner within the insurance department of the Ministry of Finance.

He has published many articles in the legal and economic press. He wrote Cessions et acquisitions d'entreprises commerciales (Business acquisitions and dispositions), Cujas publications and La transmission de l'entreprise familiale (The transfer of the family business) LexisNexis publications.

He is a member of the AFA (french Arbitration Asssociation).

U.S - CALIFORNIA

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John F. Friedemann is the managing partner of Friedemann Goldberg LLP. He specialises in business, real estate, banking, and entertainment law, both litigation and transactional, and has extensive expertise in matters involving fraud and fraud-loss insurance.

He is highly experienced in matters related to contracts, especially in the context of small and medium-sized businesses, and the purchase and sale of businesses. He has been practicing law since 1984.

A graduate of UCLA and the University of the Pacific with distinction, Mr. Friedemann frequently speaks and lectures on business and banking law topics.

In 12 separate years, Mr. Friedemann has been chosen as a Super Lawyer by Super Lawyers Magazine. Super Lawyer status is given to the top 5 per cent of lawyers and is based on peer nominations, independent research, and evaluation of professional achievement. Mr. Friedemann is recognised as one of the most capable and sought-after business attorneys in Northern California.

FINLAND

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Tuomo Kauttu graduated from the University of Helsinki with a Master of Laws degree in 1988, and gained his postgraduate LL.M. from the University of Washington, Law School in 1996.

After graduating and court training, Tuomo worked for a bank, specialising in corporate finance. Subsequently, he gained experience as an attorney intern at a New York law firm, followed by the LL.M. program at the University of Washington. The focus of the LL.M. program was on corporate law and corporate taxation, mergers & acquisitions, investments, and business planning.

Since 1996, Tuomo has advised and represented businesses in Helsinki. He has worked on commercial transactions and international operations in a diverse range of industries, including technology, machinery, energy and manufacturing. He has advised various forms of business entities on corporate law and governance issues. He has represented corporate clients and institutional investors in acquisitions and other transactions involving the purchase or sale of businesses.

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Steven M. Goldberg is a founding partner of Friedemann Goldberg Wargo Hess LLP and is a certified specialist in Estate Planning, Trust & Probate Law by the California Board of Legal Specialization of the State Bar of California.

He has been recognised repeatedly by national legal publications and by his peers, and is regarded as one of the preeminent estate planning attorneys in the nation.

Mr. Goldberg has comprehensive experience with sophisticated estate planning techniques, tax strategies, complex trust and estate administration matters, business law and business succession planning. He has also been recognised three times as Lawyer of the Year for Trusts & Estates in the North Bay by Best Lawyers and US News & Review.

A 1984 graduate of the UC Berkeley School of Law, Mr. Goldberg has given lectures on a variety of estate planning and tax issues. He serves on the Board of Directors for the Community Foundation Sonoma County.

UAE

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Thomas is general manager and Partner at Paoletti Legal Consultant, a global legal services firm advising clients across the Middle East, EU and the rest of the world.

He has more than 20 years of experience in sophisticated corporate, real estate, finance and technology related matters, on all sides of a transaction.

Along with being a member of the Italian Bar of Rome, he has an active role in several organizations in UAE. He is Vice President of the Italian Business Council and the Italian Social Club of Dubai. He is also listed as a lawyer at the Italian Embassy in Abu Dhabi, Italian Consulate in Dubai and the Italian Trade Commission in Dubai.

Before moving to Dubai, Thomas was partner at Studio Legale Paoletti in Rome for more than 10 years.

Thomas received his Law degree from the University of Rome, after completing his graduation thesis as a visiting scholar at Yale Law School.

U.S - TEXAS

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Donald Looper is a tax lawyer whose practice focuses on project finance, project development, and structuring partnership, corporate, and international transactions.

His skills for structuring and managing international business transactions have resulted in his being selected by clients to manage international projects negotiated in 36 foreign countries and across the United States.

U.S. clients utilise his tax and project management skills to navigate treaty issues and manage acquisitions in foreign countries, including supervision of local lawyers and accountants, tax reporting, and contracting.

Among his areas of experience are U.S. and U.N. regulatory sanctions against foreign jurisdictions and designated nationals. The 1994 case of Looper v. Morgan, upholding his measures to protect client privileged work product and communications, stemmed from Don's legal role managing an international refinery and marketing acquisition while complying with international sanctions against Libya.

Don enjoys a close working relationship with executives and GCs, representing public and privately held companies and private equity funds in a variety of industries. In addition to his representation of upstream and midstream energy companies.

POLAND

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Robert is the founder and managing partner of Dr Lewandowski and Partners. He is head of the Warsaw and Wrocław offices. He has previously worked for major legal firms in Warsaw and London and has written many legal books and taught university courses in English, German and Polish.

Robert studied mathematics and German philology at the University of Warsaw, before studying law at the University of Mainz / Germany and passing the second state legal examination in Mainz/Germany in 1998.

He enrolled in the list of German attorneys in Frankfurt am Main (2000), then, from 2001 – 2005 he worked as a lawyer at Gleiss Lutz in Warsaw/Poland which included secondment to Herbert Smith in London.

He became an independent lawyer in Warsaw in co-operation with Derra, Meyer & Partners, co-founding the Polish branch of DMP Derra, Meyer & Partners before founding Dr Lewandowski and Partners. During the last ten years he has overseen the establishment and development of the two Polish offices while practising and advising clients in his position as the senior figure.

What are some of the common reasons that private enterprises might take on minority shareholders?

Bruno Pichard – France (BP) A family-owned company in France may want to open its share capital for various reasons.

First, the owners may want to realise value, though they are not able to withdraw cash from the company. This is either because the company doesn't have the cash, or because, for tax or legal reasons, it is more convenient to sell or open the share capital to someone else.

The company may also need to develop its activities and find cash to finance new development. This financing may be done by bank loans, but it can also be done by increasing share capital, which for the company may be more comfortable. When share capital is used, the company doesn't have to repay a loan. The shareholders may have to buy back the new shares, but not the company itself. The most popular route to raising capital really depends on the minds of the shareholders. Some family-owned companies really do not want to open the share capital and so they will always prefer bank loans. Other firms are more reluctant to use loans and they prefer to increase the share capital.

Sometimes there is a minority release, meaning that some members of the family want to sell their shares or get money from the company. In such a case, the other members of the company may not have the available cash and so they need a third party to finance this withdrawal.

Another possibility includes the joint venture. This may be used when a company has to make an alliance with a competitor or somebody else in the same market. In such a case, it may be useful to have a common company through a joint subsidiary. This can also be achieved through the opening of the share capital of the family company.

A final reason to open share capital, is as an executive incentive. In France, in a family-owned company, executives may feel that, as they are not members of the family, they do not have the same opportunities they may have in another company. For instance, private equity funds which own French companies, may open the share capital of the company in which they invest. This gives executives or senior executives, a significant opportunity to make capital gains which attract less tax than salaries.

Alex Canham – England (AC) In the case of family run enterprises, it can be tempting to keep the shareholding within the family and with people who are trusted. However, minority shareholders can add value to a company.

Minority shareholdings have to be offered for the right reasons. In England and Wales some of the more common reasons for offering a minority shareholdings are to bring an expert into the company, to grow the company by way of investment, or as part of an employee share scheme.

Rather than simply offering an employment role, an expert may be incentivised by being offered a minority shareholding. Not only does the company get the benefit of their expertise, but the expert has the opportunity of benefiting by way of increased value in their shares by helping to grow the company.

Employee share schemes are often used as a way to incentivise key employees, by offering them the option to purchase a small shareholding in the company. This option is normally not able to be exercised until the employee has been with the business for a certain period of time. The option is often granted for an agreed price, and this means that if the value of the business grows then the employee is able to effectively buy the shares at a discount. If the share scheme is drafted in the correct way it can also provide the employees with a tax advantage in the event that the option is exercised. It is therefore crucial to take specialist legal advice if considering implementing an employee share scheme.

Minority shareholdings for investment are commonly offered to individuals who are looking to invest money in private businesses, and simply make a return on their investment. The laws of England and Wales prevent private companies offering their shares for sale to the general public. Therefore, this option is typically used if the company knows of individuals who may be interested in supporting the growth of the company by way of investment.

Steven Goldberg – California, U.S (SG) In our practice, taking on minority shareholders is often focused around the transfer of wealth from an older generation to a younger generation.

This occurs both from an operational (soft) side and a legal and tax perspective in the USA. There is a still a significant estate tax for large estates, so developing minority shareholders can dramatically reduce that tax.

John Friedemann – California, U.S (JF) As an interesting perspective, my practice more often deals with companies that take on minor shoulders because they're looking for capital.

That's the core difference between Steve's practice and mine, because he's dealing with high net worth clients that are looking at estate planning and generational transfer. I'm looking more at traditional businesses that don't have those circumstances.

U.S - California - SG In family businesses we are often structuring executive compensation. We see that a lot up here in California with wineries, where a certain prize winemaker may get a percentage of the winery. It is also done to keep key employees in place.

Minority shareholders have some informational rights, but they don't have a lot of control. This lack of control translates to a lack of liquidity and marketability and actually drives down the value of minority interests. In other words, it is often the case that all of the parts are not worth the same of the whole.

U.S - California - JF If you're evaluating an ownership interest, then a person with more than 50 per cent ownership is going to get full value measure of appraisal for that value. Somebody with a minority interest will have a minority discount, which might be up to 30 per cent.


Thomas Paoletti pictured at the 2018 IR Global Annual Conference in London

US - California - SG With transfer taxes in the United States, valuation is very important. A niche group of appraisers are often used to value minority interests and discounts can range from 30 per cent to 60 per cent depending on a variety of factors, including cash flow, leverage, and the size of the business.

Germany - MS There are four areas where I can see constellations in Germany that lead to shareholders taking on minority shareholders.

In Germany, we have very traditional companies which are driven by certain families over generations. They have a generational problem because younger generations are not willing to drive the business forward. In this case, someone takes over as managing director and this person quite often gets a stake in the company.

The second area is a management buyout (MBO), which happens quite often in the automotive sector. Key employees who have influence in the company may enter into it as a minority shareholder.

Thirdly, we quite often see a merger of two companies, usually a small company and a larger company. The shareholders of both companies found a holding company and become shareholders in this holding company. The holding company then owns the two former companies.

Minority shareholders can also be created when venture capital is required.

One main issue in transactions is with respect to companies who have real estate. This is in order to avoid the tax on the transfer of real estate when you sell the shares in a company. The solution is that the old shareholder maintains 6 per cent, so there's no tax on the transfer of shares regarding the real estate, which is in the target company.

Do you have the same in the US?

U.S - California - SG The US does not have a similar rule. If you have a sale of shares in a US company, there would generally be tax on that sale if there is a gain. There are strategies that we use to minimise or defer tax. The tax is levied, typically, on the difference between the seller's cost (adjusted for a variety of factors) and the proceeds from a sale.

Don Looper - Texas, U.S - (DL) We have three very different practices here, which gives a very different look at this issue.

I would say 95 per cent of all our minority investing work is representing private equity funds. Money is a key factor in why the transaction is happening, but the primary benefit is typically to gain a strategic partner.

The drafting of those agreements is materially different. Steve is focused on the minority interest holder breaking up the family interest so that the values are lower for estate tax purposes.

Our focus when drafting those agreements is almost always focused on maximising the value of that minority interest. That comes in the form of mandatory distributions and the mandatory decision making authority of the minority interest.

It is materially different when you're drafting the agreements and you're representing the minority interest. Your goal is to make that minority interest very valuable and possibly even a secured transaction.

Another reason we might do this is to create strategic partners. We have one client in Arizona that has an international agriculture pesticide company, they have sold a minority interest in some of their subsidiaries, purely for strategic purposes. Once that party becomes a minority shareholder, they have an incentive to always buy their product from the majority owner. The owner then locks in a natural sales stream.

The minority investor is coming in with capital and they are dictating the terms, which makes that minority interest very valuable. They might have mandatory distribution rights, or the essential veto rights on decision-making. They could also have clawbacks or provisions that would entitle them to increase their ownership in the event that certain performance criteria or thresholds are not satisfied. That's a very different type of drafting and they're usually highly negotiated transactions.

U.S - California - JF You touch upon an interesting dichotomy in these transactions. If the transaction is generated by the owner wishing to pass to another generation, then it's an owner-driven transaction. If they need venture capital, then it's an investor-driven transaction and now it's an entirely different set of documents and entirely different terms because the investors have all the power in that situation.

U. S - California - SG There's obviously very different motivations. If I'm counselling a family on a transfer of wealth, the motivation for the transfer is usually very different than unrelated business partners, who are looking to maximise profit. Within families, gifts are common. However, unrelated business partners usually have similar motivations as Don's clients; they will try and get the best deal that they can.

Lavinia Junquiera - Brazil (LJ) Businesses may need to offer equity to third parties to obtain further capital, skills or expertise. Thereby founders can also sell shares, have liquidity.

This process of selling shares needs to protect the company and its shareholders from loss of control, hostile takeovers, and disputes between shareholders in the controlling block. Professional advisers can obtain insights from multiple stakeholders to identify their individual goals, needs and possible compromises. They apply legal tools that help find solutions to restructure the company while reaching multiple goals to bring harmony and stability for the company´s continuing success.

Robert Lewandowski - Poland - RL There are currently around 823,000 family-owned enterprises operating in Poland. They make up between 60 per cent and 90 per cent of all SME businesses in Poland. The two most common forms are limited partnership and private liability companies.

These private enterprises might consider taking on minority partners/shareholders to finance growth projects, increase the value of their enterprises or to acquire other enterprises on the market.

Comprehensive analysis carried out in Poland shows that most enterprises still prefer to take loans from banks to finance future endeavours (over 77 per cent). The issuing of shares on the stock market, or venture capital investment, is not widespread, however this alternative is becoming more popular in Poland.

Family-owned enterprises are not used to going public (being enlisted on the stock exchange market), therefore private equity is still the most common means of equity funding in Poland. This may take many forms, such as venture capital (gaining capital at an early stage of a family-owned enterprise) or mezzanine capital (mixture of own and foreign capital).

John Colter - Mexico - JC Family owners often pursue a share reorganisation to achieve their goals. This could be parents who own a family business and wish to bring their children into ownership but retain voting control. In such a situation, the parents can convert common stock to preferred voting stock and then issue a preferential stock dividend on the remaining common stock – which is non-voting – to the children. Such stocks will not be entitled to vote in certain matters, such as increasing or reducing capital stock participation, merging the company or certain transfer of ownership, among others.

Another reason is when the private company needs investors to achieve a special project and wants to transfer certain stock participation ownership in exchange for a determinate joint venture project.

It is common to set up drag-along and tag-along terms and conditions on the joint venture. This means that, after the project is complete, they may have the opportunity to return their capital participation on the company.

Private companies normally raise finance though financial institutions, such as banks, and they normally grant certain kinds of mortgage and pledge guarantees to secure the loans. They may grant a pledge over their own stock certificates to secure the debt been granted, but is not common to bring on third parties that will finance the company in exchange of a stock participation.

Thomas Paoletti - UAE - TP From a UAE perspective, we have to take into consideration that we may have family companies which are reputable in the market and are not keen on accepting investors or minority shareholders. They tend to protect themselves, because there are some activities which may only be run by Emirati families.

Other companies may seek investors, and typically this happens during the start-up process. During the process of setting up they find investors who are willing to invest and put some equity into the company. It's quite difficult for a start-up to have access to bank loans so they might consider equity.

Financial loans facilities are only available if you have at least three years of activities and you have a verifiable audited balance sheet of the company. Otherwise, it is quite difficult to have access to bank loans or banking facilities.

In some situations, these investors want to control the terms of governance of the company.

They want to make sure that the investment is properly addressed to the requirements of the company and they also take a stake in the company.

The well-known Emirati families typically have an exclusive agency agreement and act on behalf of big corporation like Microsoft, IBM or CarreFour. Any transaction these companies wants to do in the region has to go through these families. They will also typically put their own people in the management because they want to have some sort of control around how the business operates.

Only an Emirati family can have this kind of business. Foreign investors cannot run them.

Tuomo Kauttu - Finland - TK Minority owners realising value, is not one of the most common reasons to open the share capital of a company in my experience. Realising the value of whole stock is much more common.

It's difficult to find buyers who are prepared to pay the real price of the real value of a minority share of the company. Family companies are operated differently than public companies or private companies that are not family owned.

Generally, buyers don't think that owning minority shares has a real value. If the firm is operated by the majority shareholders, it means you really don't need such shares. In most cases buyers gain higher profit by investing in other kinds of companies.

There are many cases just around shareholder agreements. It is not common for owners to realise the value of their shares by selling shares to outsiders, if that is a minority share of the company.

It is a totally different situation when we are discussing financing the growth or expansion of the company. It's much more common to distribute shares to outsiders to get capital or equity in the company. In many cases, those outsiders who are intending to contribute equity to the company attribute a different value to such shares than the owner.

There are many tools, investors can use to protect their ownership in the case that the shares are distributed by the company in exchange for equity, in comparison to the situation in which the shareholder is realising his or her minority shares' value.

Generally, owners can protect their ownership and power by shareholder agreement, class of stock, and redemption and consent clauses in by-laws/articles of the company in addition to similar conditions in shareholder agreement. Naturally, an investor has much more influence to all of such tools when the shares are distributed by the company due to need of capital rather than sold directly by minority shareholder. Similarly, the existing shareholders can improve their rights against new shareholders, depending on the negotiation power on both sides.

There are also some other relevant reasons for opening share capital, including tax planning. In some case in this is why the family owners are obtaining minority shareholders. Generational shift or transition to immediate family or a third-party due to retirement is also a reason, as is expansion into foreign countries.

SESSION TWO - MITIGATING RISKS

What are some of the risks inherent in making changes to the structure of share capital? How can clients legally ensure they retain control within the family? Any examples?

Brazil - LJ The legal puzzle around maintaining control may include the following considerations.

Should the company have only one class of shares or multiple classes, with different economic and/or voting rights, and should the controlling block be organised in one or more holdings through a shareholders' agreement.

They must also consider the major economic and political powers that the shareholder(s) cannot compromise, plus the risks that they will not take, and the level of protection inherent in this structure.

Rules around conflict of interests, transactions with related parties and corporate governance in shareholders´ agreements or memorandum and articles should also be included.

In the latter situation there should be a thought about whether the management functions can be reinforced. The involvement of the shareholders in the management or board of directors should also be considered. The application of remedies and conflict resolution methods concerning these shareholders and the company, is important.

Poland - RL Most family members insist on keeping control over the enterprise after taking on a minor shareholder or a minor partner. They are interested in limiting the rights and powers of a new investor, however, there is always some risk of losing control, for instance in the case of the enterprise being indebted or via a hostile takeover through redemption of shares.

Control will be ensured through signing family favourable investment agreements (partner agreements or shareholder agreements in addition to their formation agreements) between family members. The new investor will be kept away from key issues involving the running and development of the enterprise.

This can be done by limiting casting votes attributed to shares/interests offered to a new investor and not allowing a new investor to be involved in decision making process.

In such circumstances the new investor is limited to a passive position. They are vested with rather poor rights and powers. This may be wish of family members, however, new investors usually try to gain more influence over business, leading to tensions and disputes within the negotiating process.

Mexico - JC While the steps required for a share reorganisation may seem simple, a great deal of effort is required to manage communications regarding governance changes. For family businesses, in particular, shareholder communication is critical to ensure that there is buy-in and everybody ends up where they intended. It is important that shareholders understand the impact in terms of board seats, voting rights, preference, subordination and dividends vs. interest payments.

For many family businesses, there is also an emotional aspect if the reorganisation results in ownership differences between various family members.

Those who pursue a share reorganisation must understand that if a company gives away stock, and the only difference in the stock is voting rights, all shareholders have the equal right to participate in the firm's profits. Thus, owners must decide whether they are ready to give up a percentage of ownership in the company, even if through non-voting rights. In short, in most shareholder reorganisations, all shareholders have shared economic interests whether they hold voting or non-voting rights.

In family-owned companies, it is now more common for the family to be very involved in the board and committee meetings and to structure the family protocol to minimise the risk of a loss of control or a hostile takeover. They may also set up internal family rules to negotiate any dispute between them.

England - AC Company law in England and Wales provides protections for minority shareholders who start to acquire rights once they own a least 5 per cent of the company's shareholding.

However, in order to make meaningful changes to the structure of the company, you need to own at least 50 per cent of the shares. To force through some fundamental changes to the company's constitution, you need to hold or control at least 75 per cent of the shares. The easiest way to ensure that the family retains control, is to make sure not to offer more than 24 per cent to minority shareholders. The family should also strongly consider putting in place a shareholders' agreement governing rights that attach to the shareholdings. They should also consider whether they offer the minority shareholders a different class of share with different rights attached to them.

Hostile takeovers tend to be less of an issue for small private companies, as the minority shareholder would need to get enough of the other shareholders on side in order to force through changes to the structure of the company.

Disputes between family members, however, can be more common, and can cause major issues in running the business effectively. Most decisions of the company are made by the directors, and so if key family members also act as directors and fall out, this can prevent day-to-day decisions being made. In family companies, the shareholders and directors are often the same, and so if there is a dispute it is normally difficult to get agreement to remove a director.

There is no specific provision within company law in England to deal with a difference of opinion in relation to the strategy of a company. The running of the company is undertaken by the directors, and if the shareholders have a difference of opinion regarding strategy their most powerful remedy is to seek to remove the director. If the dispute is between directors, then they will need to reach a commercial conclusion.

UAE - TP In the UAE we have different kinds of companies. We have a company set up in the Free Zone and a company which is set up on the mainland. The difference is that Free Zone companies can be 100 per cent owned by foreigners, while mainland companies must be 51 per cent owned by a local Emirati entity or individual.

In the case of a mainland company the best thing in order to mitigate the risk is to have a shareholder agreement in place. Typically, the shareholder agreement takes care of the key governance issues and makes sure that the shares are pledged in favour of the investors and the local partner should release power of attorney. You should make sure that during the process of the incorporation of the company, the profits are distributed between the partners in a different proportion. For example, in Dubai the minimum that can be allocated to the local Emirati partner is 20 per cent of the profit.

A similar solution is suitable for the free zone companies. Since the free zone authorities are more or less like an administrative authority (i.e. they don't take any decisions with a direct impact on the company structure or business), any dispute between partners is to be prevented or solved in the articles of incorporation or with appropriate shareholder agreements.

Court proceedings should always be avoided and in our experience we see that shareholders' agreements are the proper tool to prevent and mitigate any risks during the life of the company. If you don't have unanimous consent, you will be forced to go to court and get an order from the court.

We had a case, where a client was holding 95 per cent of the shares in a company in a Free Zone of UAE. The other 5 per cent was in the name of an Indian individual who was also the manager of the company. The majority owner was not able to change the manager because unanimous consent was required.

Usually the shareholder agreement has to take into account different aspects of the business. What we need specifically is that the local partner is holding the shares on behalf and in trust for the investor. This should ensure correct profit distribution and make sure that there's a proper governance structure in place.

These are the elements that we will usually take into account when we have to deal with this kind of situation.

Finland - TK I would say that in all cases shareholders' agreements are relevant. Beyond this, according to Finnish law it is possible that the bylaws/articles of the company contain conditions, especially redemption and consent clauses, that can help to manage these things. Also, class of stock may affect to proceeding when making changes to capital structure.

France - BP If a family-owned company opens its share capital, the new shareholders will ask for some rights. This might include asking to participate on the board of directors, or access to specific information on the management of the company, or its turnover.

There are some risks for the company in these requests. The first one is that there will be new directors within the company as well as new shareholders. It means that the management of the company may become more complicated, so it has to be a serious consideration.

The second point is that if there are people who are investing in the family-owned company, there is a risk of indiscretion as regards the information disclosed by the company to the new shareholders or to the new directors.

The members of the family will lose a part of the control of their company and they have to accept this. People are not going to invest in the company without getting some rights and control of its management. This is true even if they do not want to be involved directly in the management of the company.

Sometimes in France, it happens that new investors take advantage of some dispute which may exist between family members. They might side with one group of family members against the other group, just to get a majority control of the French company together with the first group. At the end of the day, they are able to take over the whole company because all the members of the family prefer to sell their shares to these new investors, rather than to keep on fighting each other.

If the dispute doesn't go as far as the sale of the company, there can be a dispute regarding the strategy of the company. This may happen between the members of the family and the new investors who may have different point of views. It is necessary to take into consideration this possible dispute and how it would be solved.

It can be possible to mitigate the risk by using different types of shares. Investors can then invest in the share capital of the company, but their voting rights can be reduced, so they will not be proportional to their shareholding. This may also be done through a shareholders' agreement, where the members of the family may have some priority rights.

We also need to consider the needs of the members of the family, not only from a business perspective, but also their private needs. If, for instance, we realise that one minority shareholder member of the family needs cash to buy a flat, or to help his children, this shareholder will look to find a solution. This might include selling shares to a new investor.

U.S - California - JF We have seen clients who have started up new businesses and had some success. When they are ready for the next stage, they will come to us and ask about taking on investors.

At that point we have a very serious talk with them about what the implications of that are. They've been running that business as their own private business, but now they're going to have minority owners. There's a huge risk to them if they don't understand the implications of bringing on investors. The investors will want things from them, such as information, control and accountability.

In the transactions in which we are involved, there is very significant risk of serious regulatory liability when investors are taken on. If they don't follow all of the requirements for disclosure under securities law, for example, the original owners could face serious liabilities.

U.S - California - SG If you discussing a family group, versus unrelated parties, the analysis is different, but even within a family group, the older generation often wants to retain control. A fairly common strategy for us is to use voting and non-voting interests. This is fairly easy to do and very often the tax consequences are relatively benign.

U.S - Texas - DL In a capital transaction, you've usually got a minority shareholder with leverage. You would be specifically negotiating voting rights and voting control over certain issues.

John Friedemann pictured at the 2017 IR 'On the Road' Conference in Singapore

I would list that in three different ways. Voting control over certain issues, securing the investment by terms of the contract and then mandatory distribution, so that the majority can't prevent the distribution of profits.

When Marcus raised the issue of employees being given interest, it would be exactly the opposite here. The majority are trying to make sure that those employees do not have the right to control decisions.

Germany - MS It's also important to define what a minority shareholder is. I would say it's a shareholder with less than 25 per cent of the voting rights. In Germany, this individual would not have a veto right, and they could not oppose a shareholders' resolution. The majority, holding 75 per cent or more, has the control regarding resolutions in the shareholders' meetings.

We do, however, quite often have a problem with minority shareholders regarding controlling rights and we see minority shareholders making things hard for the managing director and majority shareholder. They can ask thousands of questions regarding the management decisions, or why resolutions were made in a certain way. We also have a lot of problems with the invitation to a shareholders' meeting. A minority shareholder can say that he has not received the letter of invitation and that there is a material mistake. You cannot avoid these risks.

U.S - Texas - DL In Germany you can contract that right though I believe. A new investor can contract the right to veto a decision?

Germany - MS Yes, that's possible.

U.S - California - JF In the US, there are ways for sellers to deal with it limiting interference from the investors, if you have the leverage.

One way is to sell a different class of shares limiting the minority owner's ability to interfere with the ongoing operation. That's one mechanism that can be used if the original owner of the company has all the power and leverage.

If they don't have that kind of leverage, then it's absolutely true that the investor is going to dictate terms that will give them the power to create trouble, because they want to protect their minority investment.

How can professional advisors smooth the process and ensure the redistribution happens efficiently and achieves its goals? Any Examples

U.S - Texas - DL In the US, it has become normal to work using limited liability company agreements for private transactions and not public companies. But even in private transactions among public companies, the use of limited liability company agreements and complex partnership agreements is happening.

In the case of structuring wealth for families or bringing in employees, it's much more common to use shareholder agreements, or often no agreements at all.

I would say that most of our transactions use limited liability company agreements that are highly negotiated with details on the rights that are given to the minority investor. This includes control rights, security rights, methods of securing the investment and possibly even ways to increase their share if the company doesn't perform to the levels negotiated.

U.S - California - JF Do you see situations where minority interests are protected by the preferred status of their ownership interest, where any dividends or any distributions get paid to them first according to certain ratios?

U.S - Texas - DL With private equity investments, there's always a waterfall distribution method of drafting the partnership agreement.

As a tax lawyer the most material difference between a private equity limited liability company agreement and a non-private equity limited liability company agreement is the method of distributions and allocations of profits.

Private equity funds tend to draft all of their limited liability company allocation provisions on what is called the target method of distributions. The agreement drafts specifically how the cash is distributed, ensuring that the private equity fund has a certain return coming back to their investors. It's based on cash and then the profits and losses are left to the accountants to figure out allocation. The private equity funds don't care, since all they're looking for is cash.

In a normal transaction between two businesses, the profits and losses section would be focused on what your share of profits would be, or what your share of losses would be and then distributions would always follow based on the capital account accounting.

U.S - California - SG I cannot resist the temptation to add that, whether it's a family situation or non-payment situation, cash flow is always important. Clients are always concerned about that.

In the family situations, we actually end up using LLCs quite a lot to establish different kinds of partnerships. This is especially true for assets like real property.

The entity structure and how we're going to govern businesses and assets from one generation to another is a big part of what we do as professional advisors. A big part of my practice in those transfers are multi-generational trusts, which probably would not be used outside of families.

I think the equivalent in Germany is a foundation. If you say foundation in the US, you're thinking of something that has a charitable requirement, but I think in Germany the foundation is a private family arrangement similar to a trust. We use all kinds of trusts to accomplish our goals as professional advisors.

We translate these structures in an intelligible way for our clients. It's very common for us to use diagrams and charts to show the clients what the legal documents are going to do. Our family clients love seeing the diagrams showing how things are going to flow. It aids their understanding tremendously.

Germany - MS Some very rich families in Germany have a family foundation and this will hold 100 per cent of the operating business of the companies.

We work with a large company, where all the profits from operations go into a foundation. The foundation then aims to invest all the money back into the company. This secures the future of the company because the profits will not go out of the family.

The family members themselves only have salary agreements and they get a salary from the foundation for their services. You do not have minority shareholder problems, because in this foundation everyone is a member, rather than a shareholder with profit interests.

U.S - Texas - DL This is actually very interesting and something we would never see in my practice.

We're currently representing an international religious organisation doing some restructuring, which has caused me to look at something else that I had really never looked at before. That is the use of limited liability companies for non-profit 501 C 3 organisations.

Delaware and two other states have specifically authorised the use of limited liability company agreements for non-profits, and then another series of 20 or so states have permitted it.

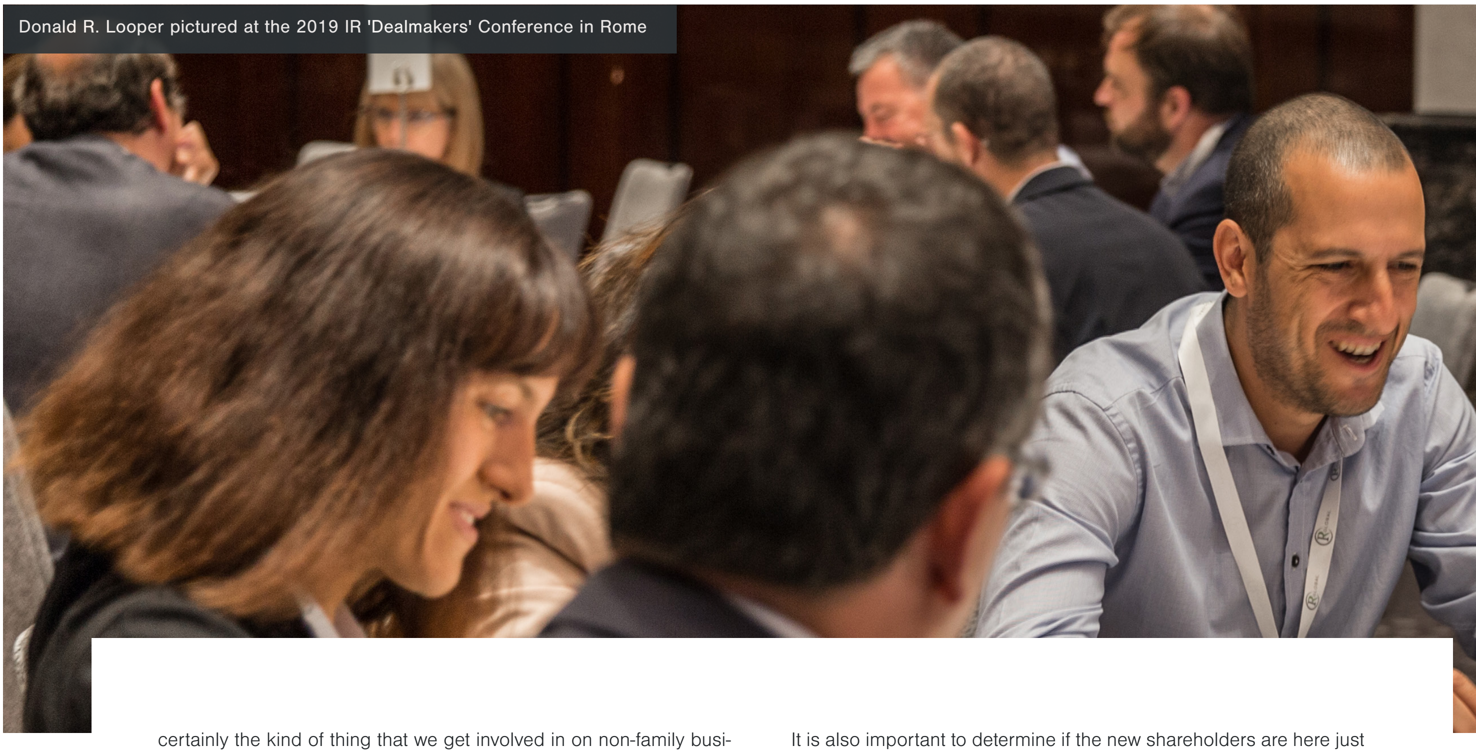
The reason I raised that is significant, because the limited liability company is used so much due to its ease of preventing piercing the corporate veil.

State laws are very good at saying that the limited liability company does not have to follow all of the procedures for giving notices to shareholders and doing all the things you have to do in the corporate context. As a result, the limited liability company is an easy form to operate with and still maintain a limited liability for the members. In a non-profit organisation structure, the parent company with a large valuable church building as an asset, can operate its for-profit activities in a separate limited liability company agreement. If an accident occurs that would give rise to liability, this insulates the non-profit parent from that activity.

U.S - California - JF I'm working on one right now, where we have European owners and Californian owners of a business. They own the business equally and there's a conflict over the direction of the company.

We're working on a resolution to resolve the future of the company. My client is the Californian entity and only the California entity. We have to always be very careful about who we represent and we can't act in the middle between different parties unless we are formally designated as a mediator. It's

Donald R. Looper pictured at the 2019 IR 'Dealmakers' Conference in Rome



certainly the kind of thing that we get involved in on non-family business transactions as well, where we resolve disputes among owners by advising the parties.

One thing I want to add, is something interesting in California. It's called judicial reference for the solution of disputes.

There are problems with arbitration and there are problems with going to traditional courts to litigate. Judicial reference is a cross between the two, using a retired judge who works privately to resolve a dispute, almost like an arbitrator, but in accordance with all of the applicable laws of California.

The parties hire the judge and direct the judge in terms of the process, so it can be done privately and quickly. It follows the law, unlike arbitration which does not necessarily follow the law, and is subject to appeal. You get a ruling that you can take up on appeal if need be and it creates a very interesting statutory alternative in California.

U.S - Texas - DL We have judges and former judges that permeate our arbitration list, but the only way in Texas to have it subject to appeal, is if the arbitration clause specifically provides that the decision can be appealed if it didn't follow the law

US - California - JF In California, it's all set up by statute, which we sometimes call our 'rent a judge' program.

France - BP As advisors, we always discuss with our clients the extent of the power they are willing to grant to new investors to avoid dispute on this loss of power.

I have seen disputes happen with a family-owned company, where one member of the family who runs the company, was not accustomed to discuss with foreigners the strategy of the company. With new investors, you will have to get accustomed to this, so the only question is how it will happen and to what extent.

What decisions will require the approval of the new shareholders is one specific point, while what kind of information will need to be provided is another.

It is also important to determine if the new shareholders are here just for a limited period of time or if they're here to stay. Some new shareholders have invested with no intention of selling the shares, but the situation is quite different when the new shareholders have decided they will sell, for instance, within five or seven years.

It is necessary during the investment process, to not only think about how the first investment is made, but also how the new shareholders can resell their shares within this period of time. In France, one solution is often an agreement between new and family shareholders, providing that if no solution is found for the sale of the new shareholders' shares, the family has to sell the whole company.

This means that if you do not have a solution within five or seven years, the family company will no longer be a family company.

It is our duty as lawyers to explain to all the members of the family, the content and the impact of the new agreement, especially if it happens that there are only one or two key members of the family who negotiate this agreement with new shareholders while the other members of the family, do not participate in the negotiation.

We do not only discuss legal aspects, but also the details of the strategy of the company and also the needs of the members of the family. This includes what their plans are for the next few years.

For instance, if it is a private fund which invests in a French company, then they may not want distribution of dividends. All the members of the family would have to accept that, for four, five or six years, there will be no distribution of dividends. This has to be explained to them, otherwise a dispute may happen.

UAE - TP Typically, a shareholder agreement is the first thing to put in place. The key things to take into account are how to secure the distribution of the profit, plus proper governance structure.

If these aspects are properly taken care of in the shareholder agreement, minor disputes among partners are unlikely and in any case far more manageable.

To this end, we typically use arbitration clauses, or the court of the Dubai International Financial Centre, because it is a system which is more like English law and a perfect forum especially for investors coming from abroad.

Finland - TK Shareholder agreements are always relevant, as are articles/bylaws of the company. In that sense, it's possible to have a redemption condition in articles or bylaws that can be used in the same way as share classes, for instance voting rights.

Brazil - LJ It is important to work with the shareholders and the company to define a clear strategy and vision and a clear corporate governance with functions. Putting in place independent managers, that act apart from shareholders, is also a crucial part of the corporate governance.

Mexico - JC Negotiating an offering of share capital, will normally be formalised first by amending the company's bylaws. Depending on the kind of transaction, the parties may also execute a joint venture agreement or a shareholders' agreement. For matters involving family, they will execute a shareholders' agreement and afterwards will execute family protocol that has been previously designated by a professional in the area.

Poland - RL The terms and conditions under which a new investor joins a family-owned enterprise are commonly subject to regulation of the shareholders' agreement, in the case of a private company, and a supplemental partnership agreement in the case of a limited partnership. These agreements must define the scope of rights and obligations of a new investor.

Additionally, the following clauses ensure a smooth realignment and maintenance of control over the enterprise by family members.

The exact identification of the purpose of investment, plus ways of providing financing by a new investor (e.g. through increase of the share capital along with providing share premium.)

Clauses around the attribution of shares to the new investor, the future distribution of profit/dividends between family members and the new investor are worthwhile, as are buyout clauses of the shares of the investor by family members after execution of investment through a drag along clause and a clause relating to the new composition of management board/supervisory board favouring family members.

England - AC There are a number of ways that professional advisors can smooth the process to ensure that a redistribution happens efficiently and achieves its goals. These include project managing the process, by prompting the parties to discuss difficult subjects at the outset (for example, what happens if there is a dispute). We can also help to implement appropriate mechanisms or safeguards, by ensuring that the rights and obligations of the parties are clearly documented, with the aim of reducing the scope for disputes in the future.

The rules in accordance with which the company must be run are set out in its Articles of Association. Shareholders will often want to ensure that agreements between themselves and minorities remain between the parties. It is therefore essential that the shareholders consider putting in place a Shareholders' Agreement.

Often when negotiating a Shareholders' Agreement, a minority shareholder who has invested significant sums in the business will want to ensure that their investment is suitably protected. This is particularly key if they will not be appointed as a director, and therefore will not be involved in the day-to-day decision making of the company. As previously discussed, the family will want to ensure that it retains adequate control of the company. One method is to set out in the Shareholders' Agreement, a list of matters which are fundamental and require key shareholder consents – these are often referred to as 'reserved matters'.

If the shares have been offered to employees as part of an employee share scheme, then the documents governing the scheme should be drafted by a solicitor to make sure that they comply with the various rules and legislation. It is usual that these employee shares will be a different class, and will not have voting rights. The aim is to provide a form of financial compensation, without giving them rights in relation to running the company. The rules need to be drafted to ensure that this is the case.

If there is a dispute between two shareholders, then it is often recommended the parties consider mediation, however there is no legal requirement to follow this path.

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