WHAT ARE SOME DIFFERENT APPROACHES TO TEACHING TRANSACTIONAL LAWYERING SKILLS? BUILDING BUSINESS AND FINANCIAL LITERACY IN LAW STUDENTS

Mary Ann Robinson*

To be a good transactional lawyer, you need to understand the deal, not just the law. That means you need to get comfortable with the numbers behind the deal. In this presentation, I will describe the one-credit Business & Financial Literacy Module that we have developed at Villanova University Charles Widger School of Law for our 1L students. This required course begins with an overview of basic financial literacy concepts, including how to read a financial statement and how to value a business, and culminates with teams of students negotiating a deal and creating a term sheet for their clients, all under the guidance and supervision of experienced practitioners. I plan to describe the substance covered and the structure of the course, outline the lessons we have learned about creating such a course (what has worked well and what is less effective), and demonstrate how we apply some of the concepts we teach by reviewing part of the problem we use.

We have run this Business & Financial Literacy Module for the last five years. We actually modified our academic calendar to begin our spring classes a week later in order to free up the students for the entire week for this Module.

By the end of the week-long Module, we want our students to be able to do the following

- Understand basic financial statements;
- Use financial statements to assess the financial position of an organization;

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- Understand, assess, and apply the concepts contained in a typical financial valuation report prepared by an accountant who has been asked to value a business; and
- Identify useful negotiation techniques.

In order to achieve these goals, we teach the following:

- Financial statements – we introduce financial statements first, primarily income statements and balance sheets.
- Finance – we do a brief introduction of some basic finance concepts, like time value of money and risk vs. reward as it relates to borrowing.
- Valuation – we introduce students to different valuation methods that could be used to value an ongoing business.
- Then we pull this all together and apply what students have learned though a two-part problem and team project that involves a company with two shareholders. First, we introduce the company and its financial situation along with the two shareholders and their roles in the company. Students get the financial statements for this company and have to become familiar with them. Then, after students have reviewed the statements, we introduce the second part of the problem and the fact that one of the two shareholders wants to get out of the business. He would be happy to sell to a third party, but the other shareholder does not want to sell and would prefer to buy the other one out. We give the students the valuation reports that each shareholder has obtained. The students use the client information and the valuation reports to put together an offer and then negotiate the purchase by one shareholder of the other one's shares.

Having explained what the goals are and what topics are covered, now I will explain how we accomplish this in just one week. Monday and Tuesday are very content heavy. There is lecture and then problems for the students to complete. It is a lot of information for them to absorb if they do not have any financial background (we have tried moving various parts of this online, but it has created some different problems—students resent spending so much time over winter break completing online lessons, so we moved the instruction back into the one-week timeframe).

At the end of Monday, when students have received instruction on financial statements, they get the financial statements for the company they will be working with the rest of the week, along with an introduction to what the company does and who the shareholders are. Students have a homework assignment to make sure they can apply the concepts they have learned. In the homework assignment, students have to answer some questions about the financial statements and the company's financial health. This is the first part of the problem they will be working on during the week.[1]

Tuesday is devoted to lecture and problems about valuation and a little finance. Then students get the second part of the problem, which lets them know that one shareholder wants to buy out the other one. They also get the valuation reports that each shareholder has had prepared. Students learn which shareholder they will represent and also receive their team assignments. When we assign students to teams, we try to evenly distribute the students who have degrees in accounting, finance, or economics so each team has at least one person with some existing expertise.

On Wednesday, the fun begins. We have a fairly large group of practitioners, most of whom are alumni, who come in to act as coaches for the teams. They review the valuation reports with the students and help them begin to craft an initial offer to buy or sell shares of the company. We also have some instruction on negotiation techniques and an opportunity for students to consult with their "client," portrayed by a 3L student.

On Thursday, students work in their teams to develop an offer to buy or sell. They consult via phone with their practitioner coach and by 5:00 PM exchange term sheets with their counterpart team on the other side of the deal.

Friday is the most fun. Students negotiate the purchase and sale of the shares under the supervision of their practitioner coaches.

To give you a better sense of the nature of the problem that students work on, please take a careful look at Part One of the problem in the handout. It explains that AppleBiz, Inc. is a closely-held company, authorized by Apple, Inc. to sell Apple products (iPads, iPhones, Apple Watch, and Mac laptops) for use in business and in similar settings that do

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[1] See *infra* Appendix 1 for the handout titled: "Business and Financial Literacy for Lawyers," which contains Part One of this problem, the financial statements, and an answer key.

not involve social media. The products, together with an ever-expanding array of apps, are used in: restaurants to make and adjust reservations; in companies with multiple drivers (like moving van lines) to organize routes and schedules; in sharing services like Uber and Zipcar; in retail stores like Urban Outfitters where the products are used for inventory control and internal communications; and for health care diagnostics such as electrocardiograms and blood sugar testing. This dual revenue stream from both products and apps is important as we think about the company's value, where its revenue comes from, and what each shareholder contributes to the company's profitability. The problem includes a list of questions that students must answer. Although we do not have time to walk through all them in this session, we can look at a few and then you can review the others on your own.

Question: Is AppleBiz a big company?

Answer: It depends on what "big" means. This is not Google, but it is a profitable company with 20+ employees.

Question: How much revenue does it have?

Answer: Looking at the Income Statement, we see that revenue for 4 months in 2017 is $6,160,000. (2016 = $15,400,000; 2015 = $12,320,000).

Question: Does AppleBiz have a lot of debt?

Answer: No. Looking at the Balance Sheet, we see that AppleBiz has no long- or short-term debt. Students need to understand the differences between large structured debt like a bank loan on the one hand and short-term trade credit and accrued expenses on the other hand.

Question: How much money the shareholders take out of the company each year and in what form or forms?

Answer: Students need to understand that the owners are taking money out of the company in the form of both salaries as shown on the Income Statement and shareholder distributions as shown on the Balance Sheet.

Part Two of the problem gives the students more facts about the two shareholders' motivations. Don (the seller) wants to retire. He thinks Meg (the buyer) is abrasive, so he is tired of dealing with her. Meg thinks she is the brains behind the company and that its success is attributable largely to her efforts, particularly in developing the apps. There are some other factual wrinkles, like Meg wanting a non-complete, but the main issue is the valuation. Students receive two valuation reports, one prepared for the seller and one for the buyer. Not surprisingly, the experts who prepared the reports emphasized different things, so the values are somewhat far apart. This gives the students an opportunity to assess the different valuation techniques and also provides the basis for a competitive negotiation. But it also puts some limits around what positions the students can take during the negotiation. In the first year or so of teaching this Module, when we did not provide valuation reports, some students took unreasonable positions regarding valuation that made it difficult to have a successful negotiation. In addition, providing the valuation reports is more realistic since lawyers would rely on an expert's valuation rather than valuing the company themselves.

If you would like to do something similar at your school, I will review what seems essential and what is helpful to have to run a program like this. First of all, you need a faculty member to act as coordinator. Like any course, it takes a substantial amount of time. And because it involves the entire 1L class, there are a lot of administrative pieces. Some of these can be done by staff, but soliciting and coordinating the volunteer attorneys, creating the problem, and interacting with students needs to be done by faculty.

There needs to be time allocated in the academic schedule—at least 15 classroom hours. Although we do this in a week, it could easily be spread out over five or more weeks.

It is essential to have an accounting expert to prepare the valuation reports. It is also essential to have an expert conducting the instruction on financial statements and valuation. We have used various models, including outside accountants in both roles. This year we had the most success so far by asking a professor who teaches accounting in our undergraduate business school to teach the sessions on financial statements and valuation. By "most success," I mean that students seemed to grasp the material better and also complained less about the instruction going over their heads. This professor is also an adjunct at the law school, teaching Accounting for Lawyers, so he had the best sense of what content he could and should cover. We still used an outside accountant to update the valuation reports that he had previously prepared.

The volunteer attorneys who act as instructors and coaches are the heart of the program. These practitioners, all of whom have substantial experience in corporate work like this, devote a lot of time to the project. They spend all of Wednesday morning with the students, reviewing the valuation reports and helping students begin to craft their offers. They review the students' proposed term sheets on Thursday and then spend all Friday morning at the law school supervising and consulting during the negotiation. We have built up this group over the years and each year we add more because people who have done it suggest others. Most, but not all, are alumni, and nearly all of them return each year because they enjoy working with the students and think this instruction is important.

While those are the essential requirements, there are also a few things that are very beneficial. It is very helpful to have additional support from law school faculty. You can reduce the size of the classes reviewing the financial statement homework on Tuesday if other law school faculty participates as well.

We also use student fellows. These are 3L students who help with the administration of the course and act as the clients both for a client consultation session and during the negotiation.

I was asked how we got faculty support for this course. It actually arose from goals set during our last strategic plan. Our dean at the time consulted with a group of practitioners who strongly recommended that students need to become financially literate. This recommendation was brought to the faculty and received widespread support. The Business and Financial Literacy Module was created in response to this recommendation.

APPENDIX 1

Teaching Transactional Law & Skills Sixth Biennial Conference:
Emory University School of Law

Business and Financial Literacy for Lawyers

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To: All 1L Students at Villanova University Charles Widger School of Law
From: Joseph Del Raso Business & Financial Literacy Module Faculty[1]
Date: January 8, 2018 (But for purposes of this problem, the date is July, 2017)
Re: AppleBiz, Inc. – Background and Financial Picture

AppleBiz, Inc. is a closely-held company, authorized by Apple, Inc. to sell Apple products (iPads, iPhones, Apple Watch, and Mac laptops) for use in business and in similar settings that don't involve social media. The products, together with an ever expanding array of apps, are used in restaurants to make and adjust reservations; in companies with multiple drivers (like moving van lines) to organize routes and schedules; in sharing services like Uber and Zipcar; in retail stores like Urban Outfitters, where the products are used for inventory control and internal communications; and for health care diagnostics such as electrocardiograms and blood sugar testing.

Meg Jobs and Donald Icahn are co-owners of AppleBiz, Inc. Meg owns 40% of the common stock and Donald owns the remaining 60%. Donald founded the company about 7 years ago and put up all of the initial capital. He is 63 years old and a semi-retired businessman. He invested 100% of the $460,000 needed to start and maintain the business before it was able to pay its bills.

Four years ago, Donald met Meg, then 40, who is very tech savvy. Meg not only understands the fullest use of the Apple products, she also has vast knowledge of business-related apps and has actually created custom apps for AppleBiz, providing technical service solutions to AppleBiz customers. She also oversees AppleBiz's R&D, where new apps are in constant development. Recently AppleBiz's revenue from the sale of app licenses and related services has exceeded revenue from sales of Apple products.

Meg purchased her AppleBiz stock from Donald over several years as she achieved revenue goals. She paid no money out-of-pocket for her 40% ownership of the company because Donald caused the company to pay bonuses to Meg in those years, which were used to pay for Meg's stock. The price for the shares Meg bought was well below what both Donald and Meg thought they were worth at the time.

Meg works full-time for AppleBiz and supervises 20 other employees and occasional independent contractors hired to do programming and app development. Donald has the title of Chief Executive Officer and works about 10 hours per week for the company.

We have seen the company's corporate charter and by-laws, which are fairly standard. We now need to become familiar with the financial status of AppleBiz. The company's internally prepared financial statement is attached.

Please carefully review both the Balance Sheets and Income Statements and answer the following questions:

1. Is AppleBiz a big company? How much *revenue* does it have?
2. Is it *profitable*?

[1] The primary author of this problem is Douglas P. Coopersmith, who is a shareholder at Buchanan, Ingersoll and Rooney, PC. It is reproduced here with his permission. The financial statements were prepared by Joseph W. Lesovitz, who is a partner at Citrin Cooperman. The statements are reproduced here with his permission.

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3. Does AppleBiz have adequate *cash flow* to conduct its operations?
4. Does AppleBiz have a lot of *debt*?
5. Does AppleBiz have any *equity?*
6. How much money do the shareholders take out of the company each year? In what form?

For Tuesday, please be prepared to discuss your answers to these questions as part of an analysis of the overall financial picture of AppleBiz presented by the financial statement. Understanding the financial picture will be necessary for you to be able to represent the AppleBiz shareholders later this week.

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AppleBiz, Inc.
Balance Sheet

	December 31, 2015		December 31, 2016		For the Four Months April 30, 2017	
Current Assets						
Cash	$ 1,060,000	38.3%	$ 1,089,000	24.2%	$ 1,663,800	32.0%
Inventory	1,000,000	36.1%	1,450,000	32.2%	1,500,000	28.9%
Accounts Receivable	550,000	19.9%	900,000	20.0%	1,000,000	19.2%
Prepaid Expenses	10,000	0.4%	10,000	0.2%	10,000	0.2%
Total Current Assets	2,620,000	94.6%	3,449,000	76.7%	4,173,800	80.3%
Property Plant and Equipment						
Leasehold Improvements	150,000	5.4%	150,000	3.3%	150,000	2.9%
Warehouse Equipment	300,000	10.8%	300,000	6.7%	300,000	5.8%
Office Furniture	50,000	1.8%	50,000	1.1%	50,000	1.0%
Data Processing Equipment	500,000	18.1%	1,500,000	33.3%	1,500,000	28.9%
Less: Accumulated Depreciation	(850,000)	-30.7%	(950,000)	-21.1%	(975,000)	-18.8%
Total Other Assets	150,000	5.4%	1,050,000	23.3%	1,025,000	19.7%
Total Assets	$ 2,770,000	100.0%	$ 4,499,000	100.0%	$ 5,198,800	100.0%
Current Liabilities						
Accounts Payable	$ 425,000	15.3%	$ 525,000	11.7%	$ 555,000	10.7%
Accrued Sales Commissions and Bonuses	300,000	10.8%	370,000	8.2%	125,000	2.4%
Accrued Pension Contribution	150,000	5.4%	180,000	4.0%	60,000	1.2%
Total Current Liabilities	875,000	31.6%	1,075,000	23.9%	740,000	14.2%
Long Term Debt	-	0.0%	-	0.0%	-	0.0%
Total Liabilities	875,000	31.6%	1,075,000	23.9%	740,000	14.2%
Stockholders' Equity						
Total Paid in Capital	460,000	16.6%	460,000	10.2%	460,000	8.8%
Retained Earnings - Beginning Balance	725,000	26.2%	1,435,000	31.9%	2,964,000	57.0%
Current Year Profit	1,460,000	52.7%	2,804,000	62.3%	1,034,800	19.9%
Shareholder Distributions Paid During Year	(750,000)	-27.1%	(1,275,000)	-28.3%	-	0.0%
Retained Earnings - Ending Balance	1,435,000	51.8%	2,964,000	65.9%	3,998,800	76.9%
Total Stockholders' Equity	1,895,000	68.4%	3,424,000	76.1%	4,458,800	85.8%
Total Liabilities and Stockholders' Equity	$ 2,770,000	100.0%	$ 4,499,000	100.0%	$ 5,198,800	100.0%

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AppleBiz, Inc.
Income Statement

	For the Year Ended December 31, 2015		For the Year Ended December 31, 2016		For the Four Months Ended April 30, 2017	
Revenue						
Product Sales	$ 6,200,000	50.3%	$ 5,950,000	38.6%	$ 2,560,000	41.6%
Services and License Revenue	6,120,000	49.7%	9,450,000	61.4%	3,600,000	58.4%
Total Revenue	12,320,000	100.0%	15,400,000	100.0%	6,160,000	100.0%
Cost of Goods Sold	8,640,000	70.1%	9,821,000	63.8%	4,011,200	65.1%
Gross Profit	3,680,000	29.9%	5,579,000	36.2%	2,148,800	34.9%
Selling, General & Admin.	1,383,000	11.2%	1,860,000	12.1%	809,000	13.1%
Depreciation and Amortization	312,000	2.5%	390,000	2.5%	130,000	2.1%
Owner Salaries[1]	525,000	4.3%	525,000	3.4%	175,000	2.8%
Total Operating Expenses	2,220,000	18.0%	2,775,000	18.0%	1,114,000	18.1%
Operating Profit	1,460,000	11.9%	2,804,000	18.2%	1,034,800	16.8%
Earnings Before Interest, Taxes Depreciation & Amortization (EBITDA)	1,772,000	14.4%	3,194,000	20.7%	1,164,800	18.9%
Depreciation and Amortization	312,000	2.5%	390,000	2.5%	130,000	2.1%
Earnings Before Interest & Taxes (EBIT)	1,460,000	11.9%	2,804,000	18.2%	1,034,800	16.8%
Interest Expense	-	0.0%	-	0.0%	-	0.0%
Earnings Before Taxes (EBT)	1,460,000	11.9%	2,804,000	18.2%	1,034,800	16.8%
Taxes	-	0.0%	-	0.0%	-	0.0%
Net Income	$ 1,460,000	11.9%	$ 2,804,000	18.2%	$ 1,034,800	16.8%

[1]Meg $375,000/Donald $150,000

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To: Faculty for Joseph del Raso Business & Financial Literacy Module Problem (Part One)

From: Douglas P. Coopersmith and Mary Ann Robinson

Date: December 29, 2017

Re: Issues to Analyze from Financial Statement for AppleBiz, Inc.

Thanks for volunteering to serve as faculty for the Joseph del Raso Business & Financial Literacy Module. As part of the Module, students will learn about Financial Statements on Monday and then receive Part One of the problem they will work on during the week. Part One just asks students to study the Financial Statement for AppleBiz and answer some questions. That's what you've been asked to review with them. (Students will receive Part Two of the problem after they learn about valuation. In Part Two, one of the two AppleBiz shareholders will buy out the other. Half the students will represent the buyer and half will represent the seller; they will negotiate the deal under the supervision of practitioners later in the week.)

For your convenience, we have included in this memo some information about what we would like you to help students think about in connection with the Financial Statement. The questions that students answered for homework and some of the suggested follow-up have two purposes: 1) to make sure students understand how to read a Financial Statement and 2) to help students see what they can learn about a client's business from the Financial Statement.

First, it would be helpful to make sure students understand the basic facts and structure of the company.

1. What does AppleBiz do?
2. How many shareholders are there? *[2]*
3. Do all the owners also work for the company? *[yes, but only one works full-time]*
4. Does anyone else work for the company? *[20 additional employees and occasional independent contractors]*

Here are some comments on the questions that we asked students to consider. (Questions are in **bold**; comments are in *italics*.)

1. **Is AppleBiz a big company?** *It depends on what "big" means. This is not Google, but it's a profitable company with 20+ employees.*
   How much revenue does it have? *Revenue for 4 months in 2017 is $6,160,000. (2016 = $15,400,000; 2015 = $12,320,000)*

2. **Is it profitable?** *Yes – Net Income for 4 months in 2017 is $1,034,800 (calendar year 2016 = $2,804,000; calendar year 2015 = $1,460,000)*

3. **Does AppleBiz have adequate cash flow to conduct its operations?** *Yes. Please work with the students in examining cash in bank and working capital.*

4. **Does AppleBiz have a lot of debt?** *No; AppleBiz has no long- or short-term debt. Please discuss with students the differences between large structured debt like a bank loan on the one hand and short-term trade credit and accrued expenses on the other hand.*

5. **Does AppleBiz have any equity**? *Yes; Equity as of 2017 is $4,458,800. Please help the students identify the equity line and the interplay of annual profits added to the prior year's retained earnings less current year distributions to shareholders resulting in current retained earnings.*

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6. **How much money do the shareholders take out of the company each year? And in what form or forms?**
   a. *Annual salaries of $525,000* ***plus*** *shareholder distributions in 2015 of $750,000 and in 2016 of $1,275,000. We suggest you note that Meg, who works full time for AppleBiz, has a larger salary because she runs the company. But the shareholder distributions are determined by stock ownership percentage, and here Donald, who only works 10 hours a week, receives the greater amount.*
   b. *The owners' salaries are highlighted on the Income Statement to help students answer this question about "how much the owners take out of the business each year." (There are other employees as well, and their salaries would be in SG&A.) Students should understand that the owners are taking money out of the company in the form of both salaries as shown on the Income Statement and shareholder distributions as shown on the Balance Sheet. This is relevant, in a rough sense, to valuation and will later become relevant (in Part Two of this problem) when we want to analyze how much cash might become available to pay for the shares of the selling shareholder.*
   c. *One thing to discuss with students about this answer is to note that there are large shareholder distributions. Is it good that the shareholders are taking out so much money? [It's obviously good for the shareholders who are making a lot of money.] Is there any reason why they might consider retaining more of it? [Maybe they would keep more money in the company if they wanted to use it to grow the business organically or to acquire another company.]*

In addition to discussing the questions, please ask the students what they can figure out about the business just from the financial statement. What do the answers to the questions above tell you?

1. *The company is doing well. The company started with just $460,000 in capital and has grown well over the years. The owners are making a lot of money and the company is healthy.*
2. *There are accrued sales commissions, so we can tell they have a sales force that works on commission, and is apparently doing a good job making sales.*
3. *Noting the sales commissions should lead students to wonder about the customer base. [If it doesn't, please suggest it.] They should want to know if the customer base is solid and comprised of repeat customers and good customer relations. Here's what you can tell them: AppleBiz enjoys very good relationships with its numerous customers, many of which have made repeat orders growing in size. However, given increasing competition and rapidly changing technology, none of the customers will make any commitments to purchase products and services in the future, even with discounted pricing. So, each customer in essence places one order at a time, any of which could be its last with the company.*
4. *Please also direct students' attention to the "Revenue" lines on the Income Statements. They should be aware of the split between revenue generated from "Product Sales" and from "Services and License." What do the numbers tell us about the nature of the business? Students should note the trend to more revenue being generated from services and licensing apps than from product sales. Revenue from services and licenses are more profitable than revenue from product sales.*

Finally, what could we anticipate might be the future of this company? Does its financial future seem bright? What might be next for this business?

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