WAR STORIES
Recollections of Lessons Learned in Practice of Law
And Some Observations about German

TRUST

The mother of a friend said she was receiving smaller distributions from an old, family trust fund despite the good performance of the stock market. She had asked the trustee (a lawyer relative) for an explanation, but he ignored her. She asked me if I could find out the answer for a fee of $1,000. I took a quick look at the New York law on trusts and saw that a beneficiary had the right to get an annual accounting at no cost. I agreed to the fee and wrote the trustee a courteous letter asking for the information. Little by little (with the time and fees mounting), I "smelled a rat." By investigation – without any cooperation from the trustee or his lawyer – I learned he had a very valuable house. I prepared an official complaint demanding an accounting and filed a "lis pendens" against the house in New Jersey. The lis pendens was justified (but only barely) if the house was purchased with the proceeds of a crime. I suspected that the trustee had stolen money from the trust and therefore some of the mortgage was paid for with trust funds he did not deserve. So long as the lis pendens was recorded, the house could not be sold without our cooperation. About a year later, we arranged for the house to be sold. My client got all the funds stolen from her and I received a fee of approximately $80,000 – all from the trustee.

BOWLING ALLEY SIGN

When I just started as a lawyer (age 25 in the United States) I was told to go to a municipal hearing to try to get a permit for a bowling alley sign. I was picked because the senior partners in the firm assumed the application would be denied. The bowling alley was on a major highway but sat away from the road, where it could not be seen. Only with a big sign would anyone passing by know where to find it. The highway was littered with ugly signs and the municipality had become very strict. In our case, a car had driven against the old bowling alley sign – which had only one poll – and collapsed. I knew the municipality would say that giving a permit would open the floodgates to other applications to signs. In the few hours I had to prepare, I found a judge's decision that a damaged sign could be replaced and that a dangerous, one pole sign, could be replaced by a 2-pole sign, which the client wanted. I gave all the members of the hearing board a copy of the case and showed them how they could use it to refuse other applications. I also pointed out the higher tax revenue the town would get from the business. We got the sign. The client gave me a fancy tie (and the fee) in thanks.

13 TIME ZONES / GERMAN ANTITRUST

In the largest acquisition I made, the Seller had 13 companies, all of them selling assets in 13 different time zones. Part of the closing documents was a chart I prepared showing the location of each selling company, its time zone, its bank account, the amount to be received and the times when the banks would be open. The Seller's attorney (from David Polk, a major Wall Street law firm) said he had never seen such a complex transaction and said I should frame the chart. Making the transaction more

complex, German antitrust authorities blocked the sale of the German assets pending further investigations. So, the client could not buy them for another year. In the meantime, the client had to be assured of getting an essential material from the German company and the Seller had to be sure that the client would buy those assets as soon as the German authorities gave their approval. The possibility also existed that that approval would never come. The original agreement covered all those risks and the second transaction closed after the German antitrust authorities approved it.

RENTING A PLANT

A major US company made a specialty pigment for a German client. The Seller threatened to shut down production if the Germans did not buy the equipment and inventory and rent part of a building where the pigment was produced. But how long should the lease run and at what rent? What happened if the US company decided to sell the building? Taking all the production assets out of the building would be far too costly and would disrupt production. I formulated a right of first refusal along with the lease and had it filed of public record with other real estate records in the county. Several years later, the German client discovered that the building had been sold with its knowledge! After litigation, the American Seller had to buy back the building and sell it to the German client.

In a similar situation, a Japanese pharmaceutical company bought a German one with a plant on Long Island, New York. The Long Island facility was not very important in the overall deal and the Japanese did not bother to conduct any investigation or to obtain proper representations or warranties regarding that plant. Years earlier the German family owner had – for tax reasons – bought the facility in a separate entity. Then then had leased the facility to the operating company. The plant itself was worthless, but the stainless-steel processing piping and related equipment was worth many millions and could not be efficiently removed and reassembled. When the lease between the operating company and the real estate company expired, the Japanese had to pay a very high price to buy the real estate and what they THOUGHT was their own equipment.

When renting a factory, remember that the landlord has the right to have the factory returned in the same condition as it was in when the lease began. Possibly generations of engineers, lab technicians and others have made modifications, assuming that the factory would always be there. Walls and stairways have been built and taken down. When we had our old basement oil tank replaced, the contractor failed to measure the stairway to the 130-year old basement. Since the house switched from coal to oil, an entrance to the basement had been blocked. The extra costs and delays were significant.

And in yet another case, the Buyer had failed to buy all the client records, such as the name of the purchasing agent or prices historically charged for products. The Buyer was not happy to have to buy those records separately.

ESPRESSO MACHINE RECOVERY

A German manufacturer of high end, restaurant coffee makers (espresso and cappuccino) wanted to settle a dispute with a dissatisfied restaurant. We worked out the mutual release and return of purchase price, but it took special prodding for the manufacturer to consider the risk that the restaurant might keep both the returned purchase price AND the machine. The right to getting back the machine is not the same as actually having the machine. We worked out a procedure to deliver the check as the movers took the machine out the restaurant door. I used the same procedure as General Electric used when a

financially weak client took possession of locomotive engines for refurbishing – payment only upon receipt / receipt only upon payment. These are essentially like drug deals. If one party does not perform, the court system does not provide a satisfactory remedy. Whenever a client has a dispute regarding something moveable, the question is – who has possession of the object. If not the client, can the client get the object without violating the law?

REPRESENTATIONS AND WARRANTIES VS. INDEMNIFICATION

A German company bought a St. Louis, family-owned chemical company and got representations and warranties about environmental risks. I also built in indemnification clauses protecting the Buyer against future 3rd party claims based on events prior to our purchase. The reps and warranties lasted a long time, but finally expired. After their expiration, ex-employees of customers claimed that working with the St. Louis products caused cancer. The Sellers (all individual family members who sold stock) claimed they were not liable because the reps and warranties had expired. But we pointed out that the indemnification for liabilities which had arisen before the sale were never cut off. The selling family had to reimburse the German company its costs. The Seller's law firm paid part of those costs and held an in-house seminar of indemnification provisions.

A German company bought a very old plant from a big US chemical company. This happened within a month after New Jersey enacted major environmental litigation requiring the Seller to clean up dirty sites. (The Seller had put off the closing two months and thereby incurred the clean-up costs. Those costs were double the purchase price!) About 8 years later, the German company sold the same site to an English company. The same environmental law now applied to the German Seller. But its obligation was secondary to that of the US company. Indeed, we had written that if the source of contamination could not be determined, it would be allocated in accordance with the time each owner had been in possession. Since the Germans had been owners for less than 10% of the existence of the plant, the risks were low. The English Buyers twice demanded indemnification from the German Seller and were defeated. About 20 years later, the city brought a claim against all three companies – the US, the German and the British. By our strategy, the Germans paid nothing.

Two chemical companies, one German and one Swiss, split the assets of a US chemical company. The product produced by the Swiss was dependent on a raw material made with the assets and formulation purchased by the German one. The German-Swiss supply contract was 5 years. During the 5 years, the Germany company had run into financial difficulties and needed every cent of possible income. The Swiss company had assumed that any product increase would be in accordance with inflation. Instead, we calculated how much the Swiss production company was worth – because a German refusal to sell would have shut it down. The Germans got their price, but it was A bitter experience for the (much bigger) Swiss company.

KNOWLEDGE

Sellers often try to qualify their reps and warranties with the word "knowledge" as in "to the best of Seller's knowledge there are no customer claims." Sellers may even say "to the best of Seller's knowledge after diligent investigation." But either way it is almost impossible to determine if or when Seller had knowledge. In each step of negotiating the transaction it becomes more expensive for the Buyer to back out of the deal. And after the purchase, the Buyer has to hope to find an internal Seller's memo confirming its own knowledge. Only then is Seller's knowledge clear.

Two mechanisms deal with these problems. First, the later in the negotiating and purchasing process, the more the non-disclosing party should have to pay, thereby encouraging faster disclosure. Second, after the closing, the Seller should not be allowed to rely on a "knowledge exception." Instead, Buyer may presume that Seller knew – even if it didn't – and give Seller an allowance for damages the Buyer has to bear. The allowance may be one big amount and/or smaller amounts for each knowledge instance. If Buyer can prove that Seller knew of a materially false statement, the resulting damages should be still higher or not be reduced by the allowance.

In one acquisition from a Dallas company represented by a smart fellow I knew in high school, we (the Buyer) discovered that the Seller had promised the workers higher wages if the transaction went through. The promise would be binding on the Buyer. When we confronted the Seller with the falsehood, he told us he would have changed the schedule closer to the closing. We broke off the deal but did not have a claim for our expenses to date. In later transactions, we provided that the Seller would cover our expenses in such cases.

So, what happens if the Seller claims it did not know of the problem, but Buyer DID learn about it before buying the property. This is known as "sandbagging" or "close and sue." One of the purposes of due diligence is to find out the condition of the property being purchased. The state of knowledge of the Buyer and Seller arise in various combinations:

1) neither Seller nor Buyer knowing;

2) Seller knowing and Buyer not;

3) Seller not knowing but Buyer knowing; and

4) both Seller and Buyer knowing.

Then there are variations on these situations such as WHEN each found out and disclosed the problem in the course of the transaction and the extent to the Buyer's or Seller's knowledge. Did one of them willfully ignore evidence which should have led to a full knowledge of the problem? Some of these situations do not permit full, clear analysis of the problem, especially under short time deadlines. These are not simple situations to negotiate, especially with the business owner present in the negotiations. The Seller is usually genuinely outraged at the idea that the Buyer might sue based on a problem the Buyer knew about and the Seller did not.

But there is another way of viewing the problem. If Buyer discovers a potential problem and discloses it to the Seller, the parties can 1) ignore it, 2) adjust the price, or 3) break off the deal. Certainly 3 is bad for the Seller, especially since it will have to disclose the problem to any future Buyer. 1 It is also bad for the Buyer, who has made plans and incurred expenditures for something the Seller had a better opportunity to discover. 2 could be bad for either Buyer or Seller, depending on what losses actually flow from the problem. They could be significant, or they might be minor. Indeed, the problem might be solved by simply getting a permit. Assuming that the Seller has negotiated a threshold (losses the Buyer bears) and a cap on all damages other than ones intentionally inflicted on the Buyer, the Seller has protections. Taking the time to research the scope of the problem slows down the transaction and increases fees. So there is a good argument for NOT disclosing every problem found in due diligence and proceeding to the closing.

Some Sellers will argue that they can only give a “knowledge” representation because they do not know the representation to be true and they do not want to lie. Seller has to point out that someone has to take the risk and usually the Seller is in the better position to do so. [This may not be true if the Seller is a financial investor and the Buyer is in the industry or is management.] The representation is not about lying but about risk allocation. If the transaction involves real time pressure, there may not be much opportunity to collect and disclose the needed information.

CONFLICTS OF INTEREST

A major international law firm took on the representation of a US client in “you bet your company” litigation in Germany. After a year and great legal fees, the international firm discovered that it had a conflict. It tried to get a waiver but could not. So, what to do? It began to respond slowly to the US client and generally give bad service. After some months, the American client fired the international firm. It asked for copies of the litigation papers. The Frankfurt office said it was too busy. So, we sent over several German-speakers to make the needed copies. In the process, they discovered internal memos disclosing the problem and proposing the poor service means of getting fired.

Later, the soft-spoken, gentlemanly head of our firm asked for a meeting in London with the head of the international firm. The Brit accused the American of having blindsided him. The best defense is a good offense.

IRAN

While working with a major Frankfurt law firm, I became involved in trying to free up a German bank’s assets frozen by the Office of Foreign Asset Control in Washington, DC. These were very tense times, with American diplomats held hostage in Teheran. The bank was involved in financing the importation of Persian carpets and had the word “Iran” in its name. We pointed out that the bank was a normal commercial bank subject to the supervision of BaFin, the German bank supervisors, and that the owners could not be determined since they held bearer bonds. At first the risk was that the bank would never get the funds back. Later, when I was stationed in Washington, the risk was that the funds would be swept up and sent to Teheran. Fortunately, during that year in Washington, I had gotten to know the people at OFAC and had a telex machine at my disposal. We had also gotten a letter from the Iranian government that it did not WANT the funds of this bank. On the day the funds were to be transferred, I was able to intercept them and get them wired to Germany, not Iran. A year later, living in New York, I met a banker in charge of foreign banking at Chase Manhattan Bank. I mentioned the name of the German bank. Her response – How did you get those funds freed?!

GENERAL PARTNERSHIP

Decades ago a German family established a limited partnership in Illinois to manufacture and distribute a sophisticated electrical product. German tax law changed and it became cheaper to change the US operation to a general partnership. However, this created unlimited liability for every partner back in Germany. Recently, one member of the German family decided to sell his partnership interest. The document was prepared by a German partner at a major Chicago law firm. I was asked to review the document and was amazed to see that it made no mention at all of future liability for the selling partner for defective products already sold. Furthermore, I learned that Illinois law had changed since the time the general partnership was formed to provide a procedure to deal with the very risk I had (easily)

spotted. We negotiated a regulation of the risk, but I still do not know whether the Chicago partner was stupid or hoped that the Seller was. No American with any assets would ever become a general partner unless there was no risk or adequate insurance.

GOODWILL

Several times clients have bought US assets including the good will of the selling company. Later, the Seller have come back and started the same business, mentioning their prior involvement with the business they sold. By reason of the sale of the good will, we have gotten that stopped.

STRICT FORECLOSURE

A German friend and his family made a bridge loan to a little New York investment company. We took the shares of stock in the company as security. Not long after, despite multiple demands, the company did not repay the loan. I gave the company notice that we would enforce “strict foreclosure” under the UCC. By this procedure, we did not have to account for any proceeds on the sale of the stock but give up any claim for any shortfall. The company did not object (as they could have under the law). Indeed, we expected them to object and sent the notice only to get their attention. We claimed ownership of the pledged stock, followed proper corporate procedures, named new directors and officers and got signatories on the company bank account changed. We then emptied to account. About a month later, the old owners called up and said, “I guess you found the account.” Years later, the stock is worth much, much more than the initial loan.

BLACKMAIL

An expert collector of European decorative silver told me he had been contacted by a French lawyer. The lawyer claimed he had a piece of silver that had been the subject of a forced auction sale in the 1930’s. She represented the family to whom it had belonged. The expert could show that the piece he had was not described in her auction catalogue or any other forced sale catalogue. The French lawyer told him she would tell his employer if he did not give over the piece. I composed a very diplomatic letter recounting the differences between his piece and the pieces in the catalogue. Then I noted that her threat to tell his employer constituted blackmail and in the United States it would be a basis for her being disbarred. Since she was French, she might not know this and so we would await her response to the news. We never heard from her again.

BONUSES

Never underestimate the role of executive bonus calculations in structuring a transaction. A German company had bought a new line of business and merged it into an existing US subsidiary. We were told to reorganize two companies. We split up the assets and liabilities in a way which made the most sense from a legal, operational and liability standpoint. Then the in-house attorney for the older US business got involved and required us to totally redo the deal. We did not understand why until we noticed that his group of executives shed a lot of liabilities in the new structure. The liabilities moved to the other, new groups of executives. The sole motive was the bonus calculation of the in-house attorney and his group. Perhaps 20 years later I ran into the retired head of the German parent and discussed this with him. He had no idea what the motivation had been.

EFFECT OF NO TRIAL TRANSCRIPT

While working in Frankfurt as the only native English speaker in a top German law firm, I was charged with summarizing testimony at a suit against a leading accounting firm. Strangely the parties agreed to conduct the proceedings in English, so I only had to write down what was said. As is normal in a German proceeding, the judge dictated a summary of the testimony every ten minutes or so. The star witness was an accountant. He gave testimony twice, several months apart. The second time, a particular event had taken on great siginificance and he described it differently the second time. The difference was deciding to his firm's liability and he lied. I was the only one who caught the lie because his contradiction was not in the record. I found out years later that he continued to rise in the accounting firm.

BANKRUPTCY

Twice I was charged with dealing with the aftermath of failed business decisions, by shutting down operations of the US subsidiaries of German parents. In both cases we were able to settle claims and get full releases without involving US courts or going bankrupt.

SCHEDULES

Often contracts call for disclosures in schedules to be attached. By intent or mistake the schedule may contradict the body of the contract. In one case, the US subsidiary did not want to sell the product line. The German parent company did. The contract specified that the raw materials on the schedule were the only ones needed to make the product and that all were available from 3rd parties or the formula needed to make the material would be disclosed. The closing was held in Germany and the German Buyer handled the closing to save legal fees. But the Buyer's German lawyer did not pay attention to the schedule, which was first delivered during the closing. When the stock of raw materials ran out, the Buyer tried to buy new the Seller said that one raw material was secret and had to be purchased from the Seller. The Seller had spelled this out on the schedule. Fortunately, I had foreseen this trick and had inserted in the body of the agreement that in case of an inconsistency between the body of the agreement and a schedule, the agreement controlled. So, the Seller had to disclose its secret formula.

PRIVACY

Privacy is not a key aspect of Mergers and Acquisitions except confidentiality. In a small town, new people, especially if wearing suits, at a local employer will draw attention and rumors will start. Investigations of the business are hard to explain – some owners say they are renegotiating their bank loans, but smart observers know that explanation may be untrue. The owner will encounter friends on the golf course. The owner – often known for his integrity – will not be a good liar and will not like lying.

Many employers have not bothered to get confidentiality agreements with their employees. Have employees left recently with significant secrets? The employee may feel bound to the old owner, but to the new?

As to privacy, Americans are much less closed-mouthed than Germans. Privacy is a basic human right in Germany. But German companies are often based in smaller towns, where everyone knows everything, regardless of how much they talk.

KEEPING EMPLOYEES AND CUSTOMERS

Keeping employees cannot be assured. When a company is up for sale, everyone who can get another job starts looking. Assuring them that they will get a "stay" bonus for staying with the company for some

period after the purchase is usually enough. But a US employee who does not honor his or her contract cannot be sued unless there is an illegal disclosure or use of confidential information, information protected by a written contract enforceable under of the law of the employee's residency.

Customers will also leave for all sorts of reasons. Sometimes a German Buyer will improve product quality and reliability. The same is true about working conditions for employees. Requirements contracts should be closely inspected.

AMBIGUITY

A great danger for an experienced attorney is that the Seller's attorney may know the Seller well, but not be an experienced M&A attorney. If the Seller's attorney does not fully understand the contract draft, the question is whether to make it clearer or hope the lawyer does understand it. If a provision is ambiguous and negotiating clarity is likely to produce a bad but clear result for the Buyer, should Buyer's lawyer make it clearer? Even if the Buyer wants to leave it vague?

IMPROPER PRACTICES

Sometimes due diligence uncovers unexplained and improper practices. After one purchase, a German client discovered that the company was paying bribes to local government authorities (This was long before the big US crackdown on bribery.) In another case, the Buyer discovered that the owner was having an affair with a secretary and that his wife – also in the company – did not know. In another case, the treasurer – who had come from a big accounting firm – took very valuable gifts intended for clients. In this process, we also learned how valuable a company car is to the employee because to give it up is a signal to his neighbors that he has lost his job. In another instance, the US CEO bought expensive clothing on the company credit card. He explained that he was afraid to ask the European owner for a raise and he deserved one.

US and German software and accounting methods often do not fit.

DAMAGES and COSTS

Most German lawyers know that U.S. punitive damages are not enforced in Germany. But consequential damages and Folgeschaeden are also different from each other. Tort damages (Unerlaubtehandlung) are different from commercial damages.

Most American lawyers do not understand the different types of damages. They just know they do not want to pay. Lawyers copy and paste long lists of different damages (some being different names for the same damages) and say they are waived by the other side. Sometimes, the only kinds of damages which would be meaningful in case of a contract breach are the ones that the other party wants to eliminate. For example, many lawyers try to eliminate lost profits. However, in most acquisitions, the only reason to buy the target is to generate profits. The way around this problem is to propose several scenarios to the party who is more likely to breach and ask him how much he should have to pay in those cases. Usually this amount is reasonable, or at least a clear basis for productive negotiations.

An intentional breach of a commercial contract does not increase the damages that will be awarded. US Courts will not punish the breaching party for its breach. Furthermore, US courts will not enforce a contract penalty. In some cases, they will enforce "liquidated damages" – a lump sum agreed to by the

parties if calculation of the true damages would be difficult. Those damages must however be reasonable.

Particularly important are legal fees. In the US, with only few exceptions, the winner in litigation pays its own legal fees. The cost of enforcing a contract can be more than the amount in dispute. Courts and arbitrators will normally enforce a clear allocation of legal fees the parties have agreed to.

One argument against arbitration is that the parties have to pay the costs of the arbitrators. Most states, perhaps all, permit the parties to waive trial by jury. This is usually a good idea if one of the parties is foreign owned.

ARBITRATION - REPEATS

Under American Arbitration Association rules, if one of the parties is not American, that party may demand that the arbitrator(s) come from neutral countries. If the arbitrators come from common law countries, they are more likely to grant extensive discovery than if they are from civil law countries. The parties pay the costs of arbitrators. The proceedings are confidential.

LOCATION OF DISPUTE SETTLEMENT

Whether or not the parties select arbitration or regular courts, they should consider carefully where jurisdiction should be. Deciding this in civil court cases is not important unless that jurisdiction is exclusive and they submit irrevocably to that jurisdiction.

In small matters, an inconvenient location may discourage one of the parties from bothering with the dispute.

Costs will be much higher in Paris, London, Zurich or New York. How long does it take to get from the airport to the location of the proceedings? If the dispute is subject to arbitration, are there stenographers in the language of the proceedings available?

If the location is a neutral country, at least one and perhaps more of the arbitrators are likely to be from that country. If it has a civil law tradition, it will interpret contracts and the rules of evidence differently than if in a common law country.

STATUTE OF LIMITATIONS

The statutes of limitations vary from state to state and are determined by the court where the action is held, not by choice of law in the contract. So, the plaintiff may be able to shorten the statute of limitations or affect the scope of damages by where it brings the suit. The statute of limitations can generally not be lengthened by contract but can be shortened. The statute of limitations for contracts is generally shorter in southern states (traditionally debtors) than in northern states (traditionally creditors).

A statute of limitations begins to run at the closing of an M&A transaction, assuming the breach is of a representation or warranty. It is irrelevant when the Buyer first learns of the breach unless the Seller actively hides the breach. In contrast, the breach of a duty to indemnify begins when Seller refuses to indemnify. So an agreement to indemnify can be much more dangerous than a representation or warranty.

DUE DILIGENCE

Today, most due diligence is conducted in front of a computer screen in "virtual data rooms." This is supposed to be efficient. About 2000, we conducted due diligence at a plant in St. Louis. One of our team members was an Afro-American woman. Instead of eating lunch in the factory cafeteria with the other lawyers, she joined the black factory workers. She came back to the group with startling tales about the employee morale.

In Germany (perhaps other code countries, too) a Buyer cannot make a claim for misstatements which the Buyer knew or could have known to be false by reading the disclosure documents. In the United States, if the rep and warranty are incorrect and the contract is properly drafted, the Buyer can make the claim regardless of any disclosure not made in the contract (or a contract schedule). So in Continental Europe, the Buyer has to read every word and consider its implications for the risks – regardless of the Seller's representations in the contract. The Buyer has to document what the Seller disclosed. This is not so in the United States. To conduct German style due diligence in the US drives up transaction costs without significant benefits.

If the parties set a dollar amount for disclosure (for example, Seller is not a party to any contract requiring payment of more than $100,000 in any 12-month period) and then lower that threshold (say, to $50,000), the Seller has to redo its disclosure documents, to be sure even more risks have been disclosed. This process is very inefficient.

The due diligence process is very dangerous for the Seller, especially when a company is bought from a mom and pop family or from a financial owner. The Sellers simply do not know the company the way a highly professional, foreign Buyer will after close inspection. Local authorities often ignore violations of law by a local owner and the owner may not even know about the violations. Once a team of experienced lawyers and a knowledgeable Buyer inspects the company, all those defects will be learned and the Sellers will no longer be able to claim ignorance. A change of ownership often triggers a new inspection, either by law or just because official become newly aware of the company. Furthermore, If old company management (as distinct from the owners) does not benefit from the sale, it will not be motivated to see the transaction conclude successfully. Fortunately, German Buyers are usually seen as responsible and professional. Often working conditions improve after Germans buy a US company.

VALUATION OF ASSETS

A lawyer usually thinks of inventory as having value, however small. But that value can be negative – such as the cost of disposing of off-spec inventory, inventory which cannot be mixed off after the closing. I have seen Sellers try to leave large quantities of off-specification materials in the company's warehouse. Sometimes employees have hidden these materials from management. The same is true of old equipment. A factory may be a dumping ground for broken or obsolete machinery.

POST COMPANY SALE

Always a question in buying a company's assets is how to deal with accounts receivable and old inventory. If accounts receivable stay with the seller, the buyer faces the problem that the seller may use methods that disturb the on-going relationship. The seller may have no interest in maintaining that relationship. The customer does not care that the company that now wants to supply it no longer owns the account receivable. On the other hand, the customer may decide not to pay the old supplier.

Warranty claims are also difficult since the seller may have no access to new, substitute product. During the months after the asset sale, both buyer and seller may receive payments from the customers. How are these allocated? Is there a presumption that they go to tpay off old debts, i.e. of the seller?

Likewise, how is old inventory handled? If Buyer does not buy it, may Seller sell it? This inventory could disturb the market, flooding it and reducing the price the Buyer can expect to get. Even if the old product is sold outside the normal sales territory, it may find its way back in. Sometimes Seller is given a period to sell off product at agreed on prices and then is required to dispose of it in landfills. If the Buyer buys the inventory, is it packaged in a way that can be used?

NEGOTIATIONS GENERALLY

With the ease of electronic meetings and data rooms, the tendency is to do deals without any face-to-face meetings. What goes lost? Watching expressions and body language is more difficult. Casual discussions and personal information – which makes the other side more human – are difficult. I have had some very important, short discussions with the other side during “bio-breaks.” People are generally more human and approachable during meals.

Over the last 40 years, German businessmen (often engineers by training) have gotten to be very adept in English. However, most Americans have little experience dealing with non-native speakers. They do not recognize how difficult it is for the Germans to understand every point, especially if the Americans use slang, abbreviations (which the Germans may have, too, but which may be pronounced differently) and dialect and speak quickly. The Germans do not want to stop every time they are not sure what something means. Repeatedly I have gone through 3-4 points that seem to have been agreed to and asked the Germans – auf Deutsch – if they understand what they agreed to. Normally, the Germans are very good and got most or even all points. But then occasionally they will say – “Oh, no. We would never agree to that!” Then we have to go back to the other side and try to renegotiate the point. Some Americans trust the Germans in these situations but others think we are using the “misunderstanding” as a tool.

Then there are the language mistakes. “Irritate” in English is much stronger and more aggressive than “irritieren” in Germany, which just means confuse. The use of the wrong word can change the tone of the meeting.

The tone of meetings is anyway often strained by German directness. The Germans view this directness as efficient. Americans view it as rude. On a graph of sensitivity, Germans are at one end, Japanese at the other with Americans in the middle, closer to the Japanese than to the Germans. Compounding the problem is the difficulty speakers of second languages to learn the little words which soften the content.

In the context of a purchase from a family owner, often the Seller has built the company up frHerom nothing. Hearing it criticized by any Buyer, especially a foreign one, is painful, not simply financially but as a matter of justifiable pride.

CHEATING AND HONOR

Cheating and honor are difficult subjects to discuss. Germans “help” each other during high school exams. American exchange students report staying home on days when English will be tested in school. They know they will be asked repeatedly for the right answer. In the US, this is cheating and

dishonorable. A German told me that not to help would be unfair. He explained that in the US, students compete to get into the best college. Of course they do not cheat. In Germany, everyone who passes their exams gets in. So there is no harm in helping. I do not know when this sort of help ends. Certainly we have seen lots of doctorates in Germany be revoked as computers have helped find plaegerism.

In the US and England, a "gentleman's word" or a handshake has real significance. The only time I have seen this sort of assurance be violated was by a family-owned German company. The German client assured me that the violent American reaction was all "theater". It was not. I refused to work for the client after that. Of course, circumstances can change and require a change in the "deal." But that had not happened. The only thing that had happened was that the retired father of the Geschaeftsfuehrer had suddenly looked at the handshake deal and said he could have struck a better deal.

I have also heard Germans say that Americans use "sharp Yankee tactics" and so the Germans are free to use methods they would think dishonorable when dealing with Germans.

BOARD MEETINGS

American school children grow up with a simplified view of Robert's Rules of Order. Board meetings are run on this sort of basis. To take action, the Chairman asks for a motion. Someone (a board member in such a meeting) makes the motion and another member 2nds it. Then all say aye or hold up their hands to signify assent and the Chair says that the resolution has passed. The act of voting seems to be unknown in Germany in these circumstances. The Chairman simply says that – there being no dissent – the resolution is adopted.

BEING A BOARD MEMBER

Germans often do not know that being a board member imposes a fiduciary duty on them. This duty is not only to act in the interest of all the shareholders. It includes a duty to submit to the company any opportunities which could reasonably be of use to the company. This is a problem in a joint venture, if a creative German is on the board and he has plans for his inventions other than contributing them to the company. Some state statutes permit the company to eliminate this obligation, but the change has to be in the company's articles of incorporation. In our situation, the US partner of the venture refused to adopt this simple change, so the German had to resign from the board, to protect his rights to future inventions. The fact that the US partner refused to make the change is evidence that it intended to use its rights against the inventor. Note that rules for limited liability companies are different.

OFFICERS and DIRECTORS

Continental lawyers often think of a US corporate board as being senior advisors to the company. They do not understand that the board members set company policy, elect officers and authorize significant transactions. Board members function only as a group. A single director acting alone has no right to represent the company. Nevertheless, one often sees (often at the last minute) that the client intends that a director will sign a corporate document.

Continental lawyers also do not understand that a US corporation normally has a President and only ONE President. They want to name someone CEO but do not understand that CEO is not foreseen in corporate statutes as an officer. Officers are the President, the Secretary and possibly Vice Presidents, a Treasurer, and Assistant Secretaries and Treasurers.

Continental lawyers assume that corporate documents can be signed by someone holding a power of attorney. They also assume a director can give someone a power of attorney. This may also be true in the UK, but not in the United States.

Indeed, many continental lawyers assume US law, UK law and Canadian law are much the same.

BANKS

Opening a bank account has become the most difficult aspect of forming a corporation or LLC for a foreign owner. US money laundering regulations put significant responsibility on banks to know their customers. This may require face-to-face meetings with the foreign principals.

Wire transfers always take longer than expected and the amount that arrives has had fees taken out. If possible, one should get the names and phone numbers of the people in the wire room before any closing that depends on wired funds. The funds should be in the United States before the closing date.

CLOSING TRANSACTIONS

Closing a transaction used to be difficult. All the parties sat in one room, pushing big piles of paper across a table, clients asking "Why they have to sign so many documents, is it really necessary?" One extremely long closing was successful only because we provided a large bottle of vodka. It was empty by the end of the process.

Now, the parties sit in different times zones and exchange signed pages by email. This sounds like an improvement, but it makes the process much more difficult. Any document not signed at the closing is not likely to be signed. If not signed within 24 hours of the closing, the likelihood drops further. Often the lawyers have to cover some last-minute details in a side letter. Negotiating this document is more difficult if the lawyers and their clients are not in the same room.

In preparing for a closing, Rule #1 is to first take care of documents some 3rd party controls. The two parties to the deal can always write something at the last minute. If the 3rd party is another businessperson (not a service company), he may use the opportunity to demand a fee or contract change.

Any closing which is dependent on the agreement of the target's employees is particularly unpredictable.

OPINION LETTERS

I have had two problems with opinion letters. In one case, we made clear to the attorney on the other side (with a well-known Silicon Valley law firm) that we also had to be permitted to rely on its opinion, not just the addressee. We got clear, but oral agreement. We closed the transaction in reliance on the agreement. Then the attorney came back and said his senior partner had vetoed our reliance. We made it clear we would work hard to get him disbarred if he stood by this position. It was very tense for several hours, but the firm finally kept its word.

In another case we did not ask for an opinion on the ability of the borrower to enter a loan transaction. The secretary of the company was a lawyer. He signed the documents. When time claimed to pay the loan, he claimed that the corporation did not have the power to enter the transaction and it was "ultra vires." Therefore there would be no repayment. I researched the ultra vires doctrine and found that it

applied only during the pendency of the transaction. Once the transaction was completed – by the funding of the loan – the corporation could no longer use the concept to back out of the transaction.

BANKRUPTCY

I advised a major German airport on the Pan Am bankruptcy. Because of PanAm's history with post-war Germany, the airport would have made any concession Pan Am needed to survive, regardless of the airport's rights. Once Pan Am sold its routes and landing slots to another US company, the airport made it clear – by non-judicial means – that the full amounts were due.

Bankruptcy in the United States is an unhappy event. In German, it is a mortal sin, one which marks the company or family for at least a generation. German law requires repayment of a percentage of the debtor's income for 7 years after the bankruptcy "discharge." American creditors do not understand that a German company will never, ever let its US subsidiary go bankrupt, even if it makes economic sense, unless the German parent also collapses. Still, German owners should use the *threat* of bankruptcy to get compromises, even if the threat is only a threat.

In one case, the wealthy German owner of a furniture company sold it to its US manager rather than let it go bankrupt during the German's ownership. The manager got concessions from the company's landlords and suppliers and the company continues 25 years later.

JOINT VENTURES

These are usually 50-50 arrangements and are a sort of creeping acquisition. Little by little the buy-out provisions of the shareholder agreement favor one party or the other. Remember that companies grow, go through difficulties, and their owners age. Their appetite for risk and their sources of funds change over time. A company with better access to funds and less fear of risk can muscle out a smaller, family-owned company. No contract has a magic wand that can make decision making simple.

MERGERS

By chance I sat next to Hilmar Kopper, then CEO of Deutsche Bank, at an M&A conference. After hearing a long presentation by a French business school professor, Kopper offered his analysis from the floor. He said that the key elements of a merger are whether the wives of the CEO's get along, where the headquarters of the merged companies would be and whether one of the two CEO's is ready to retire. He also noted that most final decisions were not made by big teams of technical advisors but in a room with 4 to 6 people.

My experience is a bit different. The parties go through the main documents and discuss each point. Sometimes they discuss each point for ten minutes. If they have not reached agreement on a point, they put it on a list. At the end of the process, they check off the points agreed to and those that are open. Sometimes there are action points – doing research, checking for documentation, asking experts or within the company. Some of the open points can be settled quickly with this information. Then there may be two or three further steps. The next one or two consist of bundling points as global compromises. After this, hopefully there are only a few open points – fewer than 5 – left. Some of those points will be money or time points. One party will make a package offer on those points. It might be accepted. Or the other party might make a counter offer. At this point, there is not much room left. Either the next round of compromises will be accepted or the parties will take a break and reconsider.

Sometimes the parties are just too far apart. The Seller has to consider what its position will be if the employees or public have learned about the possible deal. This is always possible, even without an intentional leak.

EARN OUTS

Earn outs are a way of putting optimistic, "hockey stick" projections (great earnings prospects right after the closing) to the test. The formulation of the earn out factors is very, very sensitive. In one transaction, the German Seller of a US production company negotiated a far bigger initial payment than he expected. But he also demanded an earn out – partly to give the Buyer the appearance that he was confident about the company's future. In fact, he expected to earn nothing from it. His very savvy CFO, an American with Wall Street experience, told the German that there was real money to be made in the earnout. The German told the CFO that the CFO could have a 10% bonus of any earn-out amount he could get over a minimum. By the CFO's efforts, the earn out was almost as big as the initial payment. The Buyer was furious but could not find any manipulation of the calculations. The CFO retired a year or two later.

RIGHTS OF FIRST REFUSAL

Often when the price of some ancillary asset in a transaction can't be agreed to – usually because it is too speculative – one of the parties will suggest a right of first refusal (RoFR). What could go wrong? The price is after all based on the market. But it is not the normal market. The market knows that the initial Buyer has the inside track on any purchase and any good deal is likely to be snapped up by the holder of the right. Furthermore, the outsider has the costs of going through the due diligence and the negotiations.

Sometimes even well-drafted RoFR language opens a door that cannot be closed. Once the offeror makes it clear that it has something to sell, the holder of the right is a 3rd party to any transaction. Cutting off its rights can be very difficult. In one case, a German pharma company offered a new product to the French holder of the right. The French company said that it was interested but claimed that the product was not far enough developed. The RoFR provision had no adequate mechanism for cutting off the French rights. To sell would have resulted in litigation and that might have scared off the 3rd party.

NON-COMPETES

Some American lawyers do not know that some states will not enforce non-competition agreements. This is particularly true of ones restricting employees. The applicable law is not the law of the place of the company's headquarters but rather where the employee lives. California is particularly hostile to employment non-competes. Even California permits the Seller of a business to enter into a binding non-compete agreement.

DISTRUBUTORSHIP AGREEMENTS

US law does not generally require the manufacturer to pay its distributor upon termination of the distributorship agreement. This makes it even more unlikely that the distributor will disclose details of its distribution network. In several instances, after the distributor had been terminated, it found a similar product and drove its old manufacturer from the market. Germans tend to undervalue the contribution of distributors and employees.

INFORMATION FLOW

When a European – especially from a non-English speaking country – buys a US company, US management will fight hard to keep any lawyer who speaks the language of the home office away from the US subsidiary. That lawyer is primarily loyal to the foreign owner and has access to the foreign owner that the US management cannot control. In one case, a German, family owned company bought its US distributor. It used the distributor's local lawyer after the closing. Only years after the closing did the German management find out that the US subsidiary had been sued (for an amount greater than the purchase price) due to alleged trademark violations. The local lawyer claimed he thought US management was informing the Germans.

EMPLOYEES

Some US job applicants are very poorly educated. One company discovered that its applicants were taking a test with their girl-friends in the room. When that practice stopped, more applicants failed. They also had trouble with the drug test.

A German employee can live a better life for less money that a US employee. It is a mistake to apply German compensation standards to US employees. The main US factors are the costs of education – mainly college tuition – and health care. These factors are much more expensive than in Germany.

Twice I have seen US executives be fired when their successful policies produced compensation higher than their foreign boss's. The Germans would rather take the risk of a new, untested US executive than permit a successful one to earn so much. Mercedes Benz bought Chrysler partly to increase executive salaries in Stuttgart to US levels.

A top manager at a mid-sized German chemical company told me that its US employees were the worst of anywhere in the world – that included all parts of Europe, Brazil, Malaysia, and China.

Most of the people you meet in Lufthansa business class are engineers, heading off to make service calls on their clients. Tourist is much more interesting and less expensive.

YOU CAN SAY YOU TO ME

Even many Americans who speak German have little understanding what Sie/Du is about. Americans simply do not have the formal/familiar problem in English. We barely have the problem of Mr. Jones and Gary. We have no language form which indicates a special degree of closeness, trust and commitment. And the rules applied among Germans on this subject change with the generations and with the branches of business.

I began dealing with Germans in 1962. Only in 1979, while working in a Frankfurt law office, did I begin to understand the problem of being overly familiar. In the US, addressing someone by their first name is no indication of friendship or familiarity. However, Germans assume that all Americans want to use the du form, probably because we use first names. Usually they are correct – in part because Americans do not understand the personal commitment which comes with being on "familiar" terms.

I know Germans who qualify in America as being close friends but I use Sie with them. I have others in Germany with whom I am not particularly close but who insist we use the Du form. It is very hard to turn this offer down. (A German businessman explained this to me t business people know that negotiations

in America require them to address their American consultants with their first names. To say “Mr. Houck” would send an odd message to the Americans on the other side. The (for Americans) simple solution is to use first names when speaking English and last names and Sie when speaking German but this solution apparently creates internal tensions for the German speaker.

CARS and DRIVING

German attitudes regarding cars and driving have changed over the last 20 years. In 2018, almost all cars on the Autobahn are smaller ones. The exceptions are Audi/BMW and Mercedes Benz station wagons with big engines, often V8’s. They are the ones that pass you going 40 miles an hour faster than you are. I do not recall seeing any Porsches on the road in the last year or two. This is probably due to greater social and environmental consciousness. Also, most Germans do not have garages. And their cars are often company cars, diesels. Given the VW scandal, this may change.

Nevertheless, Germans drive very responsibly, honor the speed limit (although not like in the 1970’s and 80’s), do not drink and drive, and stay out of the left lane if they are not going very, very fast. They seldom honk their horns. Flashing lights to pass used to be common but has been outlawed.

Germans take restrictions on drinking and driving very seriously.

When parking, they do not touch (no touching at all) the other cars.

Parking garages are amazingly small and difficult to navigate.

Cars are very important and a sign of status in the corporate hierarchy. Even if the monthly lease rate is within the budget, only an executive of a certain rank should drive that model.

GERMANS GENERALLY

Drinking – Germans seldom drink hard liquor. Beer is always acceptable. Wine is often OK. Being able to TALK about Italian and Spanish reds is a plus. There are exceptions at the top and bottom of the alcohol hierarchy. At the top, good restaurants have little carts with distilled liquors from Germany and Italy. In low end bars, you may order a Korn (grain alcohol) with your beer. Korn is also available at gas stations and the check-out counter at grocery stores.

Small Talk – Germans say they don’t engage in small talk. But they talk about history, opera, ballet, theater, food, their last vacation, especially where it is warm and exotic or Sylt. Possibly it is the definition of what is small. Many talk about soccer.

University – In the US and UK, adults sort out their intellectual accomplishments by casually discussing their college years. An Ivy League university, MIT, Stanford or Chicago graduate enjoys more status than one who went to a state university. Of course, this is a very crude system. Germany has no such code of accomplishment. No university carries much additional prestige. Germans make up for this by getting graduate degrees from German and foreign universities. Within small, professional groups, having been an assistant to a prestigious professor may be impressive.

Food – German sandwiches are served half finished.

German History - Anything having to do with Hitler is much more emotionally loaded in Germany than in the US. Do not assume they use his name as readily as the English and Americans do.

Religion - I have never heard any German talk about religion except one Catholic, who said Protestant churches seemed strict, cold and judgmental. They made him nervous. A Protestant said she had never heard her minister say that there was room in heaven for people who had achieved success and some wealth in life. Churches get their funds through taxes, not through weekly collections. I have never heard a German say anything negative about Jews. I HAVE heard uncomfortable generalizations from Austrians.

Reliability - Everyone knows that Germans are very punctual. They also keep their promises. Many Americans promise something and then think they will figure out a way to fulfill the promise. If that gets to be really hard, the Americans will say, “Gee, it got to be really hard to do.” They think that is enough.

Manners are too complex to bother discussing and there are other sources of information. Table manners, greeting someone and saying goodbye, addressing them in emails – these are all more formal than in the US.

American View - The Germans most Americans think of are Bavarians or folks enjoying Oktoberfest. The more restrained north Germans have more in common with Londoners than south Germans. Sometimes you see fashionable German women at the opera wearing a fancy dirndl.

North-South - Most of the mountains are in the south, near Austria and Switzerland. There are some nice hills, in north central Germany (Hartz) and near Belgium (Eifel). The north is generally flat and Protestant (with exceptions) and the south Catholic and hilly. The south is influenced by Italy. The north by Denmark and England. (These are of course over generalizations.)

Getting Around - Public transportation is safe, cheap and efficient. But I seldom see people in business dress on public transport. The subways work on the honor system, but I have recently seen many more police teams asking to see validated tickets.

Office wear – I see very few ties in German offices. Some days men wear blue jeans.

Pacifism – Germans think almost no problem can be solved with violence. They are a major exporter of weapons but scrimp on their own military.

Office Meetings – These are normally held in conference rooms. The lawyer’s office and the area where his or her secretaries sit contain shelf after shelf of client documents in binders. Seeing those clients’ names is a breach of confidentiality unless the deal was public.

Coffee of all sorts is always offered along with little cookies. Also, soft drinks and juices.

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