

Cross Border Negotiated Deals: Why Culture Matters?

by

CHRISTOPHER KING and HUBERT SEGAIN*

Different negotiation styles in the negotiation of complex contracts observed in different cultures reflect both different allocations of responsibility within organizations as well as the degree of trust in the business relationship. Complexity of documentation associates with a low degree of trust and a desire for rent-seeking by the draftsmen. There appear to be inherent inefficiencies that prevent a simpler approach, although such an approach would result in a net benefit both in transaction costs and certainty of execution. Neither the “Harvard” approach to negotiations, nor a low context approach to communication characteristic of some very successful business cultures (e.g. USA or Germany) is universally accepted. Accordingly, however well they (demonstrably) work in a national context, the high-context approaches to negotiation (e.g. Japan or to a lesser extent England) can create risks to a transaction with parties who do not share the same context.

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* King is Vice President and General Counsel of Hunter Douglas NV. King is admitted as an attorney-at-law in New York, is on the Roll as Solicitor of the Supreme Court of England and Wales, is a Rechtsanwalt in Germany and is a European Lawyer in Switzerland. Segain is an attorney with Herbert Smith LLP. Segain is admitted as an attorney-at-law in New York and is an *Avocat à la Cour* in France. The views expressed are the authors' own.

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I. Introduction

Lawyers cannot expect anymore that their practices will be purely local. As the trend towards internationalization and globalization becomes ineluctable, an ever growing number of transactions includes an international component. Through their legal education, lawyers are not well equipped to deal with the foreign aspects of a cross border deals. They are taught, generally through practice, negotiation techniques and drafting skills that they apply in their respective domestic markets. How useful are these thinking and drafting modes when one is to apply them to cross border negotiated transactions where cultural differences¹ become part and parcel of the issues to deal with? Although it may be argued that globalization is creating greater uniformity, we believe that an awareness and proper anticipation of cultural differences, without falling into the trap of stereotyping individuals, gives a competitive edge to a negotiator that cannot be neglected.

Cultural differences affect cross border deals at different stages. The first and most obvious stage is the negotiation process. This is where most of the cultural differences will be felt at their peak since these generally imply face-to-face meetings in foreign locations. Failing to understand that negotiation is a people first business or people’s backgrounds, emotions, values and thoughts may lead to disaster.

Documenting the agreement reached by the parties is also a stage where cultural aspects will be felt and need to be addressed by the principals and their agents. We will discuss the widespread use of the English language and American type contracts and their potential consequences and usual pitfalls. We will also see that using local, rather than “international” documentation,

1 Culture has been defined in numerous ways but generally, scholars see culture as the set of important assumptions (often unstated) that members of a community share in common. Every group, corporate or otherwise, has a unique culture that is shaped by its members’ shared history and experiences (E. H. Schein, “Organizational culture and leadership: a dynamic view”, Jossey-Bass, 1985.

may under certain circumstances be more efficient for the parties both in the documentation, execution and dispute-resolution phases of a transaction.

Another aspect of the influence of cultural differences in cross border transactions is the interventionism of governments, which has recently been witnessed in Europe, in particular in France and in Spain, in order to favor the blossoming of “national champions”. We will discuss in particular the current status of interventionism and ask ourselves whether this interventionism makes sense when more than 50 % of the activity of the first 100 European companies is made outside of their country of origin.

II. Cultural differences and negotiations

Negotiation is “a basic means of getting what you want from others. It is back-and-forth communication designed to reach an agreement when you and the other side have some interests that are shared and others that are conflicting”.² In the last twenty years, negotiation has dramatically grown as a field for academics and practitioners. A number of empirical studies and papers have been published. Consulting firms have specialized in this field and now offer courses to corporate executives and government officials. Today, most leading Anglo-Saxon law schools have appointed academics specialized in negotiations who offer negotiation courses, albeit mostly focused on dispute-resolution and the trend is now slowly being witnessed in Europe.³ Although it is true that negotiation is a fact of every day life for everyone, lawyers are constantly facing negotiations whether internally to a law firm, with his client or with the other party.

In light of the large literature in the fields of business administration,⁴ micro-economics⁵ and even sociology⁶ on negotiation techniques and cultural dif-

2 Fisher, Roger/Ury, William, *Getting to yes, negotiating agreement without giving in*, Penguin, 2nd edn. 1991, p. xvii.

3 Examples are the courses in M & A negotiation at the M & A Institute at Witten/Herdecke and the new degree in business negotiations to be offered at the University of Frankfurt.

4 Very detailed from a German perspective Dülfer, Eberhard, *Internationales Management*, 4th edn. 1996. Dülfer, § 6.51 sees the main difference in cultures in respect to negotiations in the different social views as to sanctity of contracts, with the contract (in Dülfer’s opinion) being sacrosanct in the U.S. on the one hand whereas breach of a contract in developing countries is taken lightly on the other hand. Dülfer points out particularities in particular countries, for example in Korea, where local parties interpret contract in light of perceived business, personal and political positions of the respective parties.

5 For a brief overview of the microeconomic functions of negotiations, including the

ferences in general and relating to M & A in particular,⁷ the reader may justifiably ask whether two deal lawyers can make a contribution to this subject. Under the narrow definition of law from the American legal realist tradition, namely, “law is what a court decides”,⁸ the negotiation process is not a legal process at all and falls outside the bounds of legal discussion.

We agree with the law and economics scholars⁹ and post-realists,¹⁰ who consider drafting and negotiation to be private law-making and our daily work – just as the work of all transaction lawyers – to be as much legal work as our colleagues who spend their career in litigation. It goes without saying that national legislation is path and culture dependent. There is no other way to explain anomalies such as the American preoccupation on whether an action would have been brought in law or equity in historic England¹¹ or the German rules requiring Notarial authentication for sale of shares of a GmbH but not of a KG,¹² which are still¹³ the two most common corporate forms for small and mid-sized companies there and are considered largely interchangeable but for tax considerations. Another example, this time drawn from French law, is the ability for a seller of a real estate asset (but not of movables) to have the sale agreement rescinded or obtain an increase in the purchase price if it manages to demonstrate that it sold its real estate asset for less than 5/12th of its market value.¹⁴ These rules, which have an impact on cross-border M & A documentation, can only be understood in a historical context of the way the

Coase Theorem as to the efficiency of negotiations: Pindyck, Robert/Rubinfeld, Daniel, *Microeconomics*, 6th edn. § 18.

6 E.g., a very popular text drawing on sociology for inter-cultural negotiations: Thomson, Leigh, *Mind and Heart of the Negotiator*, 3rd edn. 2005, ch. 14.

7 E.g., Freund, James, *Anatomy of a Merger*, 2nd edn. 2004.

8 The view taken by the still influential legal realist movement. See, e.g. Llewellyn, Karl, *The Bramble Bush* (1951).

9 See, e.g. Bernstein, Edward, ‘Law & Economics and the Structure of Value-Adding Contracts: A Contract Lawyer’s View of the Law and Economics Literature’, 74 *Or. L. Rev.* 189 (1995).

10 E.g. Snyder, David, ‘Private Lawmaking’, 64 *Ohio L.J.* 371 (2003).

11 Although the distinction between law and equity was eliminated by statute in England, it plays a central role in many questions in the United States.

12 § 15 Abs. 2 GmbHG requires the notarial form for transfer of GmbH shares. Transfer of KG shares do not require that form even if the only asset of the KG is real estate or the shares of GmbH, the transfer of which would require the notarial form. Baumbach, Adolf/Hopt, Klaus, HGB, 32nd edn. 2006, § 105 Rn 71.

13 Query whether foreign legal forms such as the English private limited company will attain the importance in practice that they have in the literature.

14 Articles 1674 to 1685 of the French Civil Code.

law developed in the particular place.¹⁵ They appear quite understandably as arbitrary to persons outside the legal system – for example foreigners doing M & A transactions – and second nature to persons within the system.

There is no reason to assume that the private law-making process is less path and culture dependent than any other law making. Negotiations in different cultures differ markedly, both in M & A and in other contexts. Not only the style and language, the time and expense it takes to document an acquisition, and even the terms of the transaction on identical facts differ markedly depending on the cultural background of the parties and the agents – lawyers, bankers, accountants and others who assist in the process. The documentation– the private law-making – may be tailored to the specific cultural aspects of the parties or of particular agents, whose interest are only seldom identical with the parties. Indeed, the empirical evidence tends to show a high degree of path dependence and concomitant inefficiency in high-value private contracting,¹⁶ of which M & A is only one example.

In order to describe and address the cultural differences and their influence on negotiation and documentation, it is necessary to take several steps back and look at the fundamentals underlying negotiation of a M & A transaction.

Although the claims management and dispute resolution phase is not the main focus of this article, it should be noted that the same cultural differences which appear in the negotiation phase continue in the claims phase, in most cases with the same players, so the cultural differences are ultimately also relevant for the litigation, mediation, arbitration or other dispute resolution process that is used.

1. *Why negotiate?*

In many other types of high-value contracts, parties are able to use standard forms and achieve much more certainty of result with far lower costs than in M & A transactions.

15 In French law, the fact that the rescission action is only open to a seller of a real estate asset certainly finds its source in ancient Roman law and its saying: “*res mobilis res vilis*”. See further as to the Roman roots of this rule and its reception by medieval lawyers Zweigert, Konrad/Kötz, Hein, *Introduction to Comparative Law*, 3rd edn. 1998, p. 329.

16 This was forcefully demonstrated in the case of contracts for delivery of part to automobile manufacturers. Ben-Shahar, Omri/White, James, ‘Boilerplate and Economic Power in Auto Manufacturing Contracts’, 104 Mich. L. Rev. 953-82 (2006). In the empirical studies, despite very high amounts at stake and repeated negotiation between the same parties, the lawyers involved relied heavily on boilerplate precedents and did relatively little ad-hoc tailoring of the contracts to the particular supply contract.

Frequently, the very same securities (stock in a publicly-traded company) can be traded in standardized transactions at very low transaction cost – all on-exchange transactions are standardized contracts with all terms, delivery, payment, etc. – specified by the rules of the exchange. It is at least theoretically possible, at least on most exchanges, to sell a large block of shares, even a large block which would confer working or legal control over the company, over an exchange with the same standardized contract that would be used for the sale of a single share of stock. Even where the values concerned fall below the relevant merger control thresholds,¹⁷ so that there would be no legal impediment to using a standard contract,¹⁸ this is only rarely done. Instead, parties who are in a one-on-one relationship and not, for example, in a tender offer addressed to an indeterminate number of sellers, almost always choose to spend considerable time and incur large costs in negotiating an agreement, rather than accepting a truly standard agreement. Given the protections afforded by laws regulating publicly listed companies and in particular ongoing disclosure requirements, time spent and costs incurred in negotiating the purchase of a large block of shares may be somewhat lower than in a private M & A transaction of a similar size. The purchaser and its financial institutions can rely on the information made public by the issuer and other published data, such as research reports. The speed of the due diligence process is also explained by stock exchange regulatory constraints and by the danger that information on the projected transaction may be leaked, which one of the authors has addressed in greater length elsewhere.¹⁹ Whether the parties actually get value for money or even a truly custom contract is another question entirely.

a) Microeconomic justifications for negotiated acquisition agreements

aa) Structure due to externalities

Microeconomic theory provides several justifications for negotiated agreements. First, there can be net gains to be made from a negotiated transaction,

17 Merger control is not the only legal requirement that might thwart the use of a standard contract. There are other regulatory approvals, e.g. for banks, insurance companies and the like, as well as the possibility that shareholder approval may be required by the seller's shareholders, e.g. if the assets sold represent a large percentage of the business of the seller.

18 Most merger control statutes require the parties to submit the purchase agreement and wait for clearance before effecting the transfer. For example, this is the case under Art. 4 of the European Merger Control Regulation EC/139/2004. These procedures take up to a number of months. Thus, settlement in the time specified by exchange rules, e.g. in five days, would not be possible if merger control requirements apply.

19 Segain, Hubert, 'Les opérations de *Public to Private* en France: bilan et perspectives', Joly Bourse sept-Oct 2005.

the advantages of which can be split by the parties. For example, by structuring the transaction as an asset deal rather than as a stock deal, the buyer may be able to take advantage of larger depreciation for tax purposes, which may give the company a higher value.²⁰ Sometimes, the asset deal may be tax-neutral to the seller, for example due to loss carry-forwards in the target company. Due to the complexity of an asset deal, it is somewhat harder to have a completely standardized asset deal, though of course there are many forms for the purpose.²¹ One reason is there can be special problems relating to the transfer of particular types of assets (e.g. intellectual property or real property which has to be transferred in a register or with particular local formalities or subject to rights of first refusal, contracts with third parties that may require consents), so the absolutely standard agreement such as the agreement for sale of stock on a stock exchange would not work. Accordingly, the parties will have to negotiate a contract taking these issues into account or forgo the gains from the better tax position.

bb) Separation of a division

If the subject of the sale is a business operated as a division, which will only become a self-supporting entity in the course of the sale, then the parties will always need an individual agreement. These types of transactions are particularly common in countries, such as Poland or the United States (largely for state tax reasons) that do not permit full consolidation among subsidiaries. In those places, to avoid accumulating loss-carryforwards in one subsidiary and paying cash taxes in another, many businesses are operated as divisions. To separate a division from the rest of an entity, especially where there are a variety of common functions and personnel, is far beyond what a completely standard contract can do, so the parties will have to negotiate at least to some extent.

cc) Constraining strategic behavior of the parties

In addition, there is a more subtle method - and which some commentators²² think is the main method - by which a negotiated contract can create value, namely to constrain strategic behavior of the seller and thereby assure that the buyer is willing to pay the maximum price. Suppose the owner/manager

20 See, e.g. Holzapfel, Hans-Joachim/Pöllath, Reinhard, *Unternehmenskauf in Recht und Praxis*, Munic, 12th edn. 2005, Rn. 145a-145b with rules of thumb for preferences of purchases for asset or share deals.

21 For example: American Bar Association, Committee on Negotiated Acquisitions, *Model Asset Purchase Agreement*, Chicago 2001.

22 Freund, *supra* (n. 7), p. 229.

of a business has personally the know-how and contacts that are crucial for the business and has not reached retirement age. A purchaser might be willing to buy the shares for a certain price, but would have to take into account the possibility that the owner/manager would get back into business and compete with the purchased business. If the contract called for a enforceable non-compete²³ or an earn-out provision that made it attractive for the seller to stay with the business and make it a success,²⁴ then the buyer may be able to buy a better and more secure business and the seller may be able to get a better price. The high complexity of both non-competes and earn outs, the former principally in the definition of the geographic and subject matter scope and the latter principally in the so-called “vendor protections” which reflect the assumptions of the parties as to how they will work together in the earn out period and on the one hand prevent strategic moves to shift income by the buyer and on the other hand protect the buyer’s legitimate interest in the long-term integration and profitability of the company, are much too fact-specific to be dealt with by a completely standard contract. So, parties that want an earn-out or non-compete will in any case have to negotiate these provisions.

There is a more subtle reason for negotiated contracts, which mostly takes more time in negotiation than all other points combined. Certain sellers of businesses, including owner-managers, their family members and frequently corporate groups selling a subsidiary, have – or in any case should have – intimate knowledge of the company and its business prospects. Such parties have every interest to sell a company at its apex, when it is about to experience a downturn of one kind or other. The question “why are you putting the company for sale” is one of the first and most important questions every buyer asks. Purchasers continuously ask why, if all the positive information in the offering memorandum is true, the seller would want to sell the company at all. A purchaser with this view would only purchase the target at a discount reflecting a feared or expected downturn or other problem, whether financial, operational, environmental, legal, etc. The reduced price would discourage sellers with perfectly good companies from selling but not those sellers who believed there was a downturn. This would put more “lemons” in the market and make the discount higher. Due to high percentage of companies on the market which were about to face a downturn, all buyers would assume for purposes of the valuation that a downturn was imminent and dis-

23 European Commission, Notice on Restrictions Directly Related and Necessary for Concentrations, OJ C 188, 4 July 2001.

24 See, e.g. Braunschweig, Philipp von, ‘Variable Kaufpreisklauseln in Unternehmenskaufverträgen’, DB 2002, 1815.

count their price accordingly (or not make an offer at all). George Akerlof²⁵ won the Nobel Prize for identifying this phenomenon, known in micro-economics as “adverse selection” and the methods of eliminating adverse selection. Akerlof observed adverse selection in a variety of environments. Adverse selection explains such phenomena as why used-car dealers have such a bad reputation and why loan sharks rather than banks are the main lenders in rural India.

Akerlof identified several method of preventing adverse selection. One such method is advertising and reputation. This plays an important role in M & A transactions, particularly where a reputable investment banker prepares an information memorandum and accompanies the transaction. Investment bankers need to be in the market for the next deal and need to consider their own reputation. Just as McDonalds would be loath to lose its reputation and the benefit of its advertising by offering sub-standard hamburgers at a branded location, investment bankers who are trying to sell companies to institutional buyers on a daily basis, would be loath to get a reputation for selling very poor companies that did not live up to the claims in the information memorandum or oral claims they made. So their presence – albeit purchased at a high cost to the transaction – may add some value in this respect. Certainly the reputable investment bankers and even lawyers we know would refuse to participate in a transaction, whatever their legal exposure, in which undisclosed fact would completely frustrate the expectations of the buyer – leaving aside whether there would be a technical fraud.²⁶

Another method of preventing adverse selection and also shifting risks from the buyer back to the seller are representations and warranties by the seller. These costs are not merely trivial.²⁷ Especially in small transactions, drafting and negotiating sessions taking dozens or even hundreds of hours of the lawyers and parties can generate transactions costs that add up to a large percentage of the transaction. One company known by one of the authors that was bought and sold by several private equity firms paid over a five year

25 Akerlof, George, ‘The Market for “Lemons”: Quality Uncertainty and the Market Mechanism’, 84 Q. J. Econ. 488–500 (1970)

26 In light of frequently employed anti-reliance clauses, this is not only a question of the disappointment of the buyer but also of the technical wording of the contract. Such boilerplate non-reliance and disclaimer clauses do not make the moral problem better; in fact they make it worse, since the buyer has both been cheated and may have no remedy.

27 Holzapfel, Hans-Joachim/Pöllath, Reinhard, *Unternehmenskauf in Recht und Praxis*, Munic, 12th edn. 2005, Rn. 520a (negotiation of the representations and warranties takes most of the time and energy of the parties in negotiated transactions in Germany). Freund, *supra* (n. 7), p. 229, takes the same view in the U.S.

period – despite very high financial debt and large borrowings to finance growth – more in lawyers fees than in interest. Moreover, the ensuing delay and consumption of the time of the business units concerned in drafting and approving disclosure schedules are not totted up and paid as are the lawyers fees but can negatively affect the performance of the target. The process of drafting and agreeing representations and warranties and related disclosure schedules delays the whole process, which can add costs and risk to the transaction. Finally, the subsequent monitoring and costs to both parties of processing and, in the worst case, litigating representations claims is another significant hidden cost of representations and warranties.

Although even in completely standard transactions, there are some warranties, for example as to title to the shares, and although the law in some countries such as France, Germany²⁸ or The Netherlands²⁹ provide implicit guarantees of some kind, other countries, notably the common law countries, only protect the buyer against intentional fraud,³⁰ which may be difficult for a buyer to prove and therefore does not go very far in preventing adverse selection. Therefore, the purchaser usually requests more or less detailed representations and warranties and accepts the related costs to itself and the target business. Advisers, particularly legal advisers, are particularly interested in having extensive representations and warranties. First, the negotiation process greatly increases the scope of their work. Secondly, while lawyers are not usually held responsible for the poor performance of the target, whereby the distraction of the disclosure schedule is mixed with normal operating factors and would get no accolades if the transaction was without or with light representations and no problems arose, since this is what the parties expected all along, legal advisers are often afraid of being blamed if there is a problem which could have, but which was not, covered by the documentation. So long as the problem is discussed and the parties come to one conclusion or the other, the advisers can no longer be blamed. So to a greater or lesser degree – we will see the cultural impact below – advisers normally push for greater specificity, more representations and more disclosure in acquisition agreements.

Although the inquiry would go far beyond the scope of this paper it is interesting to note that the empirical evidence does not seem to support the view

28 See, e.g., Schwarze, Roland, *Vorvertragliche Verständigungspflichten*, Tübingen, 2001.

29 Hoge Raad decision of 22 December 1995, NJ 1996/300.

30 See, e.g., Dawson, John/Harvey, William/Henderson, Stanley, *Contracts*, New York, 2003, p. 484 *et seq.* This rule goes back to the *Laidlaw v. Organ*, 15 U.S. 178 (1817) decision, whereby withholding of relevant information to a party to a contract of sale (as opposed to a misstatement) is not fraud.

that warranties in M & A as a value-driving function which justify putting them in the centerpiece of the transaction, as they are in respect of the documentation. If warranties and due diligence were the main value-drivers, it would be expected that structures which result in fewer warranties and less due diligence would seriously negatively impact on valuation. Compare valuations in (i) negotiated transactions with owner-buyers who give extensive warranties; (ii) negotiated transactions (usually auctions) by private equity sellers who allow due diligence but give (almost) no warranties; (iii) friendly public transactions in which there is due diligence but no warranties, and (iv) unfriendly public transactions in which there is neither due diligence nor warranties, this view would predict successively lower valuations in (ii) than in (i), still lower in (iii) and the lowest in (iv). As every M & A practitioner knows, exactly the opposite is the case. This would tend to show that factors other than improving the valuation, possibly path-dependency, opportunistic behaviour by the parties or the agency problem in respect of the legal advisers must be behind the central position of the warranties in M & A documentation.

b) How game theory predicts how parties will negotiate

Game theory, a branch of microeconomics, seeks to describe how parties meeting ideal characteristics, in particular the homo economicus who is interested in increasing his wealth as opposed to achieving other goals, would negotiate in ideal situations. The value of almost any asset, with the possible exception of certain exchange traded commodities and financial instruments, and those only for a fleeting second, is a range and not a point. In buying a house, a seller will expect price and terms in a certain range and will expect to negotiate with a buyer, who is also prepared to pay up to a certain amount on particular terms, which amount he will normally not (truthfully) disclose to the seller. Because the value of most companies depends on a set of internal (within the company) and external (in the marketplace) factors that are more complex than for most houses, the ranges may be wider for companies. In fact, parties usually only have broad expectations as to where the negotiations will come out on a variety of issues in a one-on-one negotiation. Game theory predicts that in many cases, a particular result will represent an equilibrium between the parties.³¹ Game theory does not predict that the equi-

31 The bumpy road to the Nash equilibrium under the assumption that the parties do not know what the other party's breaking point is illustrated by Saraydar, Edward, 'Uncertainty, the Bargaining Problem and the Nash-Zruthen Solution', 1 *Theory and Decision* 1573-7187 (1971).

librium is the best solution for the parties as a whole and often it is not. This technical point was brought into the public eye by the film “A Beautiful Mind” about John Nash, who won the Nobel Prize in 1994 for having shown that this equilibrium, now known as the Nash equilibrium, is not optimal. Parties to bilateral negotiations can be trapped in situations where both parties act rationally and yet a bad or inefficient solution is reached. The most common example of this is the so-called prisoner’s dilemma.³² For example, suppose the government of Slobovistan, a fictional Central Asian country, is selling its gas pipeline company to a Western oil company. The Western oil company expects the government to be corrupt and poorly funded. It will expect tax increases or other future costs and price these into the deal. Even if the sales contract prohibits such increases, both parties know that Slobovistan as a sovereign state will be able to pass such laws in the future. Even if Slobovistan desperately needs the money from selling the company at fair value and the Western oil company places a very large discount due to the uncertainty of future taxes and would prefer a high price and legal certainty, the equilibrium will be to sell, if at all, at a low price. Both parties know that there is a better outcome but cannot achieve the outcome since they cannot rely on each other. Similarly, many M & A practitioners, particularly those who have been in the business for a long time,³³ feel that the “market practice” has taken a path that is not efficient and that rules are needed to prevent opportunism and curb the agency problem in M & A transactions.

c) *Harvard method as a cross-cultural method of negotiations*

Both with the view of reducing transactions costs and avoiding the value traps to the parties of the classical negotiation among homo economicus predicted by game theory, Raiffa³⁴ developed a method of negotiation known as the Harvard method. In his theory of negotiation, Raiffa integrated elements

32 The prisoner’s dilemma and the importance to law and economics is explained in Schäfer, Hans-Bernd/Ott, Claus, *Lehrbuch der ökonomischen Analyse des Zivilrechts*, Berlin, 1986, pp. 309 *et seq.* The dilemma is that while each party is acting rationally, in this case the state in agreeing not to increase the tax and then doing so and the oil company by paying a much lower price, both parties would be better off if they had a way to prevent the strategic behavior by the state, for example, submission to international arbitration (if this would as a factual matter constrain the state; that might be questionable).

33 Graf von Westphalen, *infra* (n. 58); Pöllath, Reinhard, ‘Grundsätze ordnungsmäßigen Unternehmenskaufs’ in Westermann, Harm Peter *et al.* (eds.) *Festschrift für Gerold Bezzemberger*, Berlin 2000, S. 549.

34 Raiffa, Howard, *Art and Science of Negotiation* (1982).

of game theory with other microeconomic principles; in particular, Raiffa shows that the games can and should be played differently if there are multiple games and not a single game. This principle, which is unfortunately sometimes disregarded by advisers and even sometimes principals, is key to the dynamics of the negotiation and the importance of trust (and, as a corollary, the cost of opportunism) and is a key factor in determining the optimum negotiation method. There is namely an overlay between the cultural differences and the factual pattern as to what will happen once the acquisition is completed. There is an emphasis in general in dealing with Asians in saving face and building relationships. Where there will factually be a continuing (supply, management, technology transfer, etc.) relationship with an Asian party, then the importance of avoiding the appearance of opportunism is greater. Similarly, even a European counterparty will hold back his opportunism to some extent if it will spoil future business opportunities.

The Harvard method is a method particularly suited for mediation and is principally the subject of legal scholarship in that context.³⁵ However, the method is least as important in the initial negotiation of a contract as in the later dispute resolution phase.

The Harvard method of negotiation calls the parties to emphasize the common goals rather than the points – such as price in an acquisition agreement – where the parties have completely diverging interest. Each party looks at the interests from the other party's point of view and proposes only solutions which might work for both parties. The method looks to eliminate false dichotomies, which are often illustrated by the following example. Two sisters have three oranges. How should they split them up? The answer depends on their objectives. When you learn that one of them wants to eat the flesh and the other one wants to use the peel to bake a cake, you realize what the correct answer is.

In M & A, externalities such as taxes, financing and financial reporting, as well as informational asymmetry can create room for solutions that can create a better position for all parties concerned. One party may want to sign before a certain date on which there is to be an earnings release or sell in a way that optimizes a foreign tax position and the other party may be completely indifferent. In a more subtle case, an earn-out or receivables guarantee may result in a higher price for a seller, who has a different expectation on earnings or receivables collection than does a conservative buyer. Or a buyer may put a

35 See, e.g. Blake, Robert/Mouton, Jane, 'Overcoming Group Warfare', *Harvard Business Review on Negotiation and Conflict Resolution*, 2000, pp. 57–86.

high value on a warranty concerning a certain aspect of the business, say the validity of a key patent, whereas the seller is sure that the warranty is true and does not put a high value on the warranty. The Harvard method frequently leads to owner-managers agreeing earn-outs to bridge differing expectations (or negotiating positions) as to future financial performance of the target. For example, if the seller insists that the company will earn € 10 million in 2008 and the purchaser argues that it can only earn € 9 million, the parties could agree to an earn out that gives the seller his valuation if the company actually earns € 10 million in the future year.

The Harvard method of negotiation has probably reduced cultural differences in cross-border M & A, in particular for market participants and advisers who are continuously in the cross-border M & A market. However, it has certainly not eliminated the differences, and, moreover, a large number of transactions have at least one party, frequently an owner/manager as seller, who is rarely or in some cases only once in his lifetime in the cross-border M & A market. In such cases, the risk of cultural clashes is particularly high.

2. *Who negotiates?*

Before initiating a negotiation, one of the first key questions a business person or principal should ask himself is whether to negotiate himself or through an agent or advisor. Corporate M & A negotiations are frequently conducted through representatives, i.e. lawyers and/or investment bankers.

Typical reasons why principals would entrust at least partially the negotiations to advisers³⁶ are the adviser's technical or negotiating skills, emotional detachment (although their reputation, and all or some of their remuneration may be at risk) and ability to engage into combative negotiations without hindering the relationship between principals who will have to work together once the deal is done. The agent should understand what matters for the principal by uncovering his real expectations, to walk the principal through the most likely negotiating scenarios (and concessions) by uncovering issues, possible solutions, and their consequences.

It should be noted in this context, that not all M & A transactions use advisers at all. A recent study by the Dutch Chamber of Commerce showed that many (small business) transactions were done with no adviser, only with advice from an accountant or only with advice from a banker. Similarly, some

36 Freund, James, *Smart negotiating: how to make good deals in the real world*, Fireside, 1992, p. 176.

small and mid-size companies do entire acquisitions in house with no outside advice.

Typical cons of using an agent³⁷ include costs, miscommunications between the agent and the principal, miscommunications about the principal's strategy with the other party, failure to see the big picture issues and also the agent intentionally or unintentionally employing a strategy that maximizes the agent's but not the principal's wealth. This "agent risk" is readily apparent where the agent is an investment bank, which will only receive a substantial success fee if a transaction goes through. In that case, a principal can expect a certain bias towards a view that would allow a transaction to go through, even if that would potentially not be the best position for the principal, for example, due to an inflated expectation of a seller as to the expected value of an earn out. More subtly, lawyers who are paid on the basis of time spent may have in some instances an incentive to create, rather than avoid, issues. Although they may take positions that appear at first blush to vigorously represent their principal's position, they may actually believe, based on their assessment of the sophistication and position of the counterparties, that bringing up the point is more likely to increase transaction costs than to result in any gain for the principal.³⁸

We have noticed that there is a tendency, at least in the Anglo-Saxon and European corporate worlds towards a more expansive role of lawyers in negotiated transactions by putting lawyers at the center of the picture at an earlier stage with extended authority. Lawyers are now brought in early in the process to identify quickly unresolved aspects, hidden difficulties, or ambiguities. Lawyers are indeed more and more often required to provide advice on areas that do not strictly form part of their legal area of expertise. For example, they could be asked to consider whether the terms and conditions of an indemnification or non-compete clause in comparable circumstances are market or even acceptable to the principal. We do not believe, however, that this tendency is widespread (although it is picking up) in Asia, Africa or Eastern Europe, where lawyers' advice may be sought at a later

37 Freund, *supra* (n. 36), p. 176.

38 This agency problem has not gone unnoticed by clients and has in some cases led to a cynical view of deal lawyers as "... *at best a transaction cost, part of a system of wealth redistribution from clients to lawyers; legal fees represent a tax on business transactions to provide an income maintenance program for lawyers. At worst, lawyers are seen as deal-killers, whose continuous raising of obstacles, without commensurate effort in finding solutions, ultimately causes transactions to collapse under their own weight.*" (Gilson, Ronald, 'Value Creation by Business Lawyers: Legal Skills and Asset Pricing', 94 Yale L.J. 239, 241–242 (1984)).

stage, and remains somewhat more confined to areas of strict legal expertise. It is therefore crucial that a lead negotiator bears in mind this cultural aspect, and perhaps does not take his lawyers to the first negotiation sessions, where this may create tensions and seen as a provocation or an augur of litigation by other parties.³⁹

When not involved in hostile takeover bids, investment bankers on the other hand generally tend to have a more limited role. In our experience, they would typically provide a strong input both on process driving and on pricing components (and their adjustments) but would rather usually take a more passive role during the negotiation of the other aspects of the transaction. This position is sometimes not easily understandable for clients, particularly when some of the aspects of the transaction clearly have an impact on the pricing of a transaction (e.g. when the length, de minimis, caps or thresholds amounts in an indemnification clause are negotiated).

Now comes the line-up issue. How many people should be around the negotiating table? When an initial negotiation meeting is scheduled, one of the first things a lead negotiator should do is to find out how many people will the other side bring to the table, and what their respective roles are. This is particularly relevant when negotiating with Asian, Middle Eastern or African counterparties who tend to negotiate in various forms of delegations.⁴⁰ For example, Western Europeans or Americans will typically avoid large delegations, and will try to limit their delegation to a couple of individuals, including a lawyer so as to be able to make good progress with good timing. Japanese delegations usually have a fairly precise authority given by their hierarchy, and tend to act jointly by taking collegial and consensus based decisions, and communicating what they are thinking in an indirect fashion. Chinese delegations tend also to be fairly large and it is not always easy to figure out who the actual leading negotiator is. African delegations are more obviously organized with a clear negotiating leader.

In any case, it is important to keep in mind that one should adapt one's team to the other side's team composition. For example, if a counterparty brings a tax specialist or other technical expert, one should do the same.⁴¹ Also, the ranks and relative positions of individuals attending the negotiation should be adapted to the other side's team composition.

39 This would be particularly true when dealing with Chinese counterparts (Silkenat, James/Aresty, Jeffrey, *The IBA Guide to International Business Negotiations: a comparison of cross cultural issues and successful approaches*, 2000, 2nd edn., p. 401).

40 Delahaye, Michel, *La négociation d'affaires*, Dunod, 2nd edn. 2005, p. 14.

41 Freund, *supra* (n. 36) p. 209.

The importance of cultural differences on group dynamics plays an important role in negotiations which should be taken into account by negotiators.⁴² For example, Japanese are group-minded, consensus-based negotiators with indirect communications styles which are often difficult to read.⁴³ In other words, each of the participants in the delegation must be convinced of the merits of a particular point and this may therefore take more time than expected. Japanese will typically not send to the negotiating table the individual with the actual decision-making power. Those individuals will not be able to commit to a particular point until their head office has given the green light to do so. On the other hand, once an agreement or consensus has been found with Japanese counterparts, it is fairly difficult to alter course. Finally their aversion to simply say “no” may be difficult for a Western negotiator who would have to decipher his counterparties’ intention when counterproposals or alternatives are suggested. This is however gradually changing with the generational changes.⁴⁴

Who should a principal pick as an advisor when it is involved in a cross-border negotiated deal? How sophisticated the advisor should be? Should the principal hire an international counsel or a local advisor? Selecting a foreign counsel should be made very carefully. Before answering these questions, a principal would have to weigh in a number of factors: the amount of the contemplated deal, whether the contract to be negotiated is the corner stone of a new business relationship, or simply an amendment to an existing contract, the strategic importance of the contemplated transaction, and the complexity of the envisaged documentation and in some cases the message that selecting a certain counsel gives to the counterparty. When a buyer engages a firm that seems to be one size too large for the transaction, the seller might see the “writing on the wall” that the seller should expect a more expensive and contentious process. The choice of a small or inexperienced firm in a highly complicated transaction might give a signal to the counterparty of lack of seriousness or sophistication. One last factor to consider is the language in which the negotiations will take place. Some parties indeed insist on the fact that negotiations take place in their local language. In those circumstances local counsel with a good working knowledge of that language and a

42 Silkenat/Aresty, *supra* (n. 39), p. 46 et seq.

43 Edward Hall (in *The silent Language*, New York, Doubleday, 1959) has ranked cultures based on their level of “contexting”. High contexting for example refers to the practice of relying heavily on how something is said over what is being said and the circumstances surrounding that communication. Low contexting on the other hand relies heavily on what is said.

44 Silkenat/Aresty, *supra* (n. 39), p. 527.

language spoken by the client could turn out to be useful as a translator and cultural gap bridge, as it is commonly accepted that language “creates an in-group and out-group dividing those who speak it from those who don’t”.⁴⁵ In addition to providing technical expertise, a foreign counsel will give advice as to whether certain behavior or attitudes can or cannot be adopted in specific circumstances. Choosing a counsel who speaks a third language, for example, a French company using a German lawyer who speaks English but not French, generally increases the risk of legal, linguistic and cultural misunderstandings. Although English is widely spoken both in Germany and France, the use of English in legal negotiations seems to bring a series of clauses and practices into the documentation process that were intended to bridge the cultural gap between Anglo-Saxon clients and French clients and law, even though a different and probably smaller set of differences exist between German and French law. Tools such as contractual penalties which are allowed both in France⁴⁶ and Germany⁴⁷ are not considered, since they are not in the Anglo-Saxon forms. Such forms do not usually provide for penalties, which are usually void under American⁴⁸ law and of doubtful validity under English law.⁴⁹ Little use is made of the default rules in French law, even though these would not be surprising to German clients.

45 Silkenat/Aresty, *supra* (n. 39), p. 100.

46 Under French law, clients have the power to reduce the amount of the penalty (article 1152 of the French Civil Code).

47 Pursuant to § 348 HGB, such penalties may not be reduced if they are made by commercial parties in the course of their business. This is often, but not always, the case in M&A transactions. For example, a contractual penalty by a natural person who owns a business comprising a “break fee” could be subject to reduction under § 343 BGB if the court determines it is unreasonably high.

48 This rule of American law has been variously praised as encouraging “efficient breach” and criticized for unduly restricting party autonomy and substituting the view of the judge with the view of the parties on the appropriate remedy for breach of contract and thereby encouraging litigation. See, e.g. for a critical view of the rejection of penalties by U.S. law and the reduction of penalties in English and other common law jurisdictions: Edlin, Aaron/Schwartz, Alan, ‘Optimal Penalties in Contracts’, 78 Chi.-Kent L. Rev. 33–54 (2003), Hatzis, Aristides, ‘Having the cake and eating it too: efficient penalty clauses in Common and Civil contract law’, 22 Int. Rev. L. Econ. 381–406 (2002).

49 Compare *Robophone Facilities Ltd. V. Blank* [1966] 1 W.L.R. 1428 (penalty which exceeds reasonable damages as unenforceable) with *Phillips Hong Kong Ltd. V. Att.-Gen of Hong Kong* (1993) 61 Build. L.R. 49, 60–61 (dicta by Privy Council that penalties are enforceable where there is no oppression). The latter is the law in Australia and Canada. *Elsay v. J. G. Collins Ins. Agencies Ltd.*, (1978) D.L.R. (3d.) 1, 15, *Esanda Finance Corp. Ltd. V. Plesing*, (1989) 166 C.L.R. 131, 140. See Miller, Lucinda, ‘Penalty Clauses in England and France, A Comparative Study’, 53 Int. Com. L.Q. 79–106 (2004).

3. Negotiation styles

Each individual uses its own negotiation style, depending on his experience, personality, or training, and every negotiation is different. There are however some basic stylistic elements that do not change and that can be categorized as follows:⁵⁰

An aggressive or hard negotiator will try to gain ground by using combative tactics such as intimidation, threats, bluff, making extreme or escalating demands, distrusting others, misleading as to his bottom line, applying pressure on individuals, demanding one sided gains as a condition to the relationship, giving few and small concessions, using false issues, making the negotiation into a contest of will. Negotiations are also used to take the pulse and its limits. Aggressive negotiators usually do not like to be pinned down with notes or minutes of conversations, protocols, letters of intent, etc. This method of negotiation is fairly widespread yet can cause irreparable damage to a relationship and lead to an unbalanced agreement giving rise to issues when the time comes to perform the agreement. The counterparty may as well not be in a position to actually perform the agreement and may therefore try to find exits to his performance obligations. His feeling of bitterness and feeling exploited may also lead him to use bad faith maneuvers in the implementation of the agreement, or favor another party with which he has obtained terms, which he does not consider to be unfair.

A cooperative or soft negotiator on the other hand, will try to gain ground by establishing a common ground, by identifying shared values, by avoiding conflicts and building trust, by using rational arguments, disclosing his bottom line, by making concessions to cultivate the relationship, justifying positions objectively, creating win-win solutions and avoiding to transforming the negotiation into a contest of will. A cooperative negotiator has at heart not to damage the relationship with "the other side". A cooperative negotiator will usually try to fix milestones and achievements in order to be able to pinpoint differences and deal with them. A cooperative negotiator can also use seductive tactics to attract sympathy.

A negotiator can also be analytical by using Cartesian or logical approaches to situations, such as the Harvard method discussed above, by gathering information, organizing it and thinking about it. The instinctive negotiator on the other hand will use his instinct in his decision-making process by typically not going through the analytical phase of a problem, resisting by impos-

50 Delahaye, *supra* (n. 40), p. 26 et seq. See also Fisher/Ury, *supra* (n. 2), p. 138.

ing a hierarchy on issues but will instead jump to a conclusion based on his perception and experience.

One of the first things a negotiator should do at the outset of negotiations is trying to determine what type of negotiating style will be used, prepare its bargaining tools and staff and his negotiating team accordingly. Although it is difficult and often wrong to generalize as different people have different negotiating styles, some general patterns may be discerned: Russian and sometimes French negotiators tend to be categorized as using an aggressive negotiating style, while Japanese or German negotiators tend to be characterized as cooperative. Anglo-American or European negotiators tend to be analytical, while Asian, and in particular Japanese negotiators, tend to use a more instinctive approach.

In addition to personality, gender, and so on, a negotiator is expected to adapt to cultural differences without stereotyping an individual, which may be risky. For example,⁵¹ he will have to learn and understand whether the communications should be made on a formal or informal level, whether oral agreements are more binding than written agreements, whether communications should be direct or more subtle, whether the relationship should be focused solely on business or should it extend to other domains, whether the negotiation should take place in a business or a more informal setting, how binding the commitments made by a party during negotiations are, who should be part of the negotiations, etc.

An author has noted that there are ten cultural characteristics that affect negotiations: the negotiating goal (contract or relationship), the negotiating attitude (win/lose or win/win), personal style (formal or informal), communication (direct or indirect), sensitivity to time (high or low), emotionalism (high or low), form of agreement (general or specific), building an agreement (deductive or inductive), team organization (one leader or consensus based) and risk taking (high or low).⁵² It is interesting in this respect to refer to extracts of a table published by another commentator⁵³ that attempts to summarize the cultural specificities according to geography:

51 Fisher/Ury, *supra* (n. 2), p. 167.

52 Salacuse, Jeswald, *Making global deals*, Houghton Mifflin, 1991.

53 Delahaye, *supra* (n. 49), p. 38.

Country	Number of negotiators	Atmosphere during the negotiations	Dialogue shape	Applied method
United States	Several with at least one lawyer	Participants call each other by their first names	The potential disputes are always considered	Fast decision-making, precise goals, and short negotiation
Latin America	Only the necessary negotiators	Possibility to make connections	Pleasant, always open to discussion	Taking the time to negotiate and to know each other
Japan	Large delegation	Conflicts are not displayed	Subtle and nuanced	Taking the time to negotiate and looking to compromise
China	Large and inter-dependent delegation	Distant and rather cold relationships	Rigid and factual	Examining each point, going back and forth
Arab countries	Large and hierarchically organized delegation	Serious	Respect of others and desire to establish an atmosphere of trust	Making concessions in return of other concessions
Sub-Saharan Africa	Large delegation in which some members do not feel concerned	Distant relationship with some attempts of domination	Firm with goals that are difficult to consider	Looking to compromise
Germany	Only the necessary negotiators	Often quite tense	Quite concrete and analytical	Examining each subject on the agenda one after the other
Great Britain	Only the necessary negotiators	Looking for good relationships (often with a tint of humour)	Friendly yet firm language	Creating confusion and long negotiations
Italy	Often several	Animated debate (often with a tint of humour)	Visual and friendly language	Looking to compromise yet remaining firm
Spain	Several	Serious atmosphere	Firm language	Concessions are not easily made
Eastern European countries	Large delegation	Tense, sometimes accompanied by a few drinks	Rigid, not very friendly	Always in a claiming, demanding position

Ideally, the flexible approach combines a high degree of organization. The Harvard method of negotiation and specific tools have proven particularly valuable in complex contracting in general and negotiated acquisitions in particular. A number of these tools are specific to contractual paradigms in international acquisitions documentation. In addition, the flexible approach seeks to build confidence in the other side in various ways.

The first tool in a flexible approach is to carefully listen to the concerns of the other party and try to address the concerns in the way that is least objectionable from one's own standpoint. For example, companies listed on a U.S. stock exchange are particularly sensitive to financial controls due to burdensome requirements imposed on them by the Sarbanes-Oxley Act. In dealing with such parties, a counterparty that recognizes this can do better, for example by trading more financial representations, which are key to such a buyer against fewer environmental indemnities, which a seller may view as more risky in a particular case.

Second, a flexible approach tries to weigh the specific facts and interests of the parties in addressing each issue. As in the other situations identified by Nash and Raiffa (such as, e.g. the Middle East negotiations leading to the Camp David accord), there is a whole body of specific learning, which is considered the stock in trade of experienced M & A lawyers and to some degree other M & A professionals, who take a flexible approach.

The flexible techniques start with the overall structure and price; the techniques which can be used to overcome differences in valuation, such as earn-outs,⁵⁴ changes in the effective date of the purchase, exclusion of accounts receivable or other assets, the value of which is in question, from the sale or committal to a repurchase obligation, are often employed in flexible negotiations.

Conditions, particular material adverse change conditions (MAC)⁵⁵ which are the subject of discussions are also conducive to a flexible approach. Materiality can be quantified (or qualified) and the buyer's right to terminate can be conditioned on payment of break fees if needed to prevent an asymmetri-

54 As to the function of the Earnout as a way to bridge a valuation gap, see Braunschweig, *supra* (n. 24), Meerkat/Roos/Wieland in Triebel, Volker (ed.), *Mergers & Acquisitions: Strategie, Steuern, Recht*, Heidelberg 2004, Rn. 1–60.

55 See, e.g. *IBP, Inc. v. Tyson Foods, Inc.*, 789 A.2d 12 (Del. Ch. 2001), holding under the law of Delaware that a general decline in the industry was *not* a material adverse change within the meaning of such a condition. Following the case, practitioners particularly in the U.S. have made the clauses lengthier, so as to spell out exactly what kind of material adverse change would allow the buyer to refuse to go forward with the purchase.

cal advantage to the buyer, who takes the advantage of an upswing but wants to protect himself against a downturn in the business between signing and closing. A financing condition can sometimes be broken down in the particular requirements for the financing and allocated in accordance with which party is best able to solve the problem; for example, the seller might have to solve a particular environmental problem, which is a condition for the loan.

Representations can often be split as to their functions: if the buyer is really trying to prevent unfairness, a knowledge qualifier could be accepted;⁵⁶ if the protection is to be against catastrophic matters, a materiality or even a “double materiality”⁵⁷ standard may be appropriate.

Specific indemnities, such as tax, environmental and litigation have their own set of compromises that a flexible party may suggest in a particular situation. For example, when it comes to the size of the cap on liability for environmental cleanup, for example, the flexible approach would openly discuss the range of expected liability based on the particular operations concerned.

In each case, the flexible party considers using the Great Equalizer: the purchase price. This would mean, for example, if the seller places a high valuation on assuming an environmental indemnity, considering a reduction in price to a level at which the buyer would be willing to assume the risk.

Although not part of the Harvard method, parties need to consider a particular aspect of cultural differences, namely false cultural differences. As to some matters, particularly where there is a broad set of possible outcomes in which it would be advantageous for both parties to enter into a transaction, parties can have an interest in taking certain matters out of their control, such that only one result (the one favorable to that party) is possible. For example, private equity firms sometimes put in their corporate charter rules against giving representations other than those relating to ownership of the shares they are selling. Cultural differences can be (mis-)used to achieve the same result. American parties use this regularly by claiming that by reason of section 404 of the Sarbanes-Oxley Act, they are particularly sensitive to accounting problems and require particularly strong financial warranties, even though there is nothing in the Sarbanes-Oxley Act that requires a particular level of warranties in acquiring a company. Swedish and Danish companies often refer to the high level of environmental protection in their own country as a reason why their directors ask for particularly strong indemnities on this point. In each case, the cultural difference may be highly influenced by the

56 See, e.g. Freund, *supra* (n. 7), pp. 247 *et seq.*

57 *Ibid.* p. 245.

desire to make a particular point “non-negotiable”. When looking at what they did in other transactions on the other side (for example, American companies as sellers), it may become clear that such “cultural” points are merely a camouflage for an advantageous negotiating position.

III. Cultural differences and documentation

The use of English language as a global communications tool has made its way into cross border M & A contracts. We will see that this may create tensions with the law that was chosen by the parties as the governing law of their relationship. We will also demonstrate that the increasingly widespread use of American type contracts is not always beneficial to the parties’ interest.

1. Language of contract

The determination of the language in which the negotiations will take place and the language of the contract are major issues.

Culture, language and law are particularly intertwined, when lawyers document civil law transactions in English, for example because it is the only common denominator between, say, a Swedish and an Italian partner, which one of the authors has addressed at greater length elsewhere.⁵⁸ From a purely legal standpoint, there are obvious problems in divorcing the language of the contract from the underlying legal system.⁵⁹ The English language is inextricably tied to one or more Anglo-Saxon legal systems, although there can be significant differences among the nomenclature and culture of the different English-speaking countries.⁶⁰ Several frequently-used words have multiple meanings. A simple example is the word “law.” Does the term in an English-language clause in a contract governed by German law saying “except as required by law” mean “Gesetz” (loi), or “Recht” (droit)? Does the term “affiliate” mean “Angehöriger” (affiliate in terms of the tax law, including family members) or “verbundenes Unternehmen” (affiliates in terms of the

58 Hill, Claire/King, Christopher, ‘How do German Contracts Do as Much With Fewer Words’, 79 *Chicago-Kent L.Rev* 889 (2004).

59 See, e.g. Graf von Westphalen, Friedrich, ‘Von den Vorzügen des deutschen Rechts gegenüber anglo-amerikanischen Vertragsmustern’, 102 *ZvglRWiss* 2003, 53–74.

60 Typical Anglicism’s in M & A include “completion”, “ring-fencing”, “disclosure letters”, or “vendor protections”. In American English, these M & A terms would be “closing”, “limitation of warranties relating to a specific subject” and “indemnification clauses”.

company law). How should a “force majeure” clause from English boilerplate be understood in a system that starts from the principle of fault, not from the principle of strict liability? Draftsmen of English language contracts often try to solve these problems with voluminous definitions and non-operative clauses.

There seems to be a significant difference in the cultural attitude towards the English language not only among different countries but also among different segments of the M & A market. Many large companies and institutions accept English language contracts everywhere. If the company is large enough, English will be the lowest common denominator among at least significant subgroups within the company. The middle-market often has different expectations. Even in countries such as The Netherlands, Sweden or Brazil in which English is widely spoken in business circles, and even more in Germany, Italy or Spain, where it is less widely spoken, middle-market sellers are afraid of the negotiation process in English and therefore put a higher value on an offer specifying that the definitive contract will be in their own language. Sellers typically do not focus on the issue that from a purely legal standpoint, an English language contract, which would have to be translated into the local language in a local courts, would normally be more advantageous to the seller, who is (due to indemnities, warranties, etc.) normally expected to be the party that would be sued and has no interest in an easy and quick remedy. Even if the parties agree to arbitration, the general advantage to a seller still holds true, since an arbitration in English for the purchase of a French company would then (usually) require that the underlying factual documents (e.g. the government’s decrees to clean up site pollution) be translated into English with the same problem. Instead middle market parties frequently fear the unknown or fear that the buyers’ lawyers could take advantage of them in a language in which they are less familiar. These fears are often correct. Non English-speaking sellers sometimes overlook strongly pro-buyer language in the English contracts and let it go through, whereas it would not be possible for the buyer to achieve the same negotiation result in a local contract. In distinction, the authors’ experience in other countries, such as e.g. Poland is quite different; even very small sellers appear to expect English language U.S. style documentation.

a) Binding version in single language or both languages

Not all cultures place the same emphasis on the meaning and binding characteristics of a written contract. For example, Japanese and Chinese counterparties may view a contract as a tool to develop a future business relationship, which can be amended and renegotiated. More specifically, in China,

although this is slowly changing, more emphasis is placed on oral promises than on written contract terms.⁶¹ It is therefore important that a negotiator places emphasis at the outset of the negotiations on the fact that a contract is a closed universe, and is to be viewed as binding.

The language that has been used in negotiations is often the language that will be used in drafting the agreement. In cross-border M & A transactions between countries with different languages, this lingua franca will often be English.⁶² When two parties intend to use English as the language of their final agreement, and one party is from an English-speaking country, the other party may be willing to ask that the contract be drafted and be binding in both English and the local language of the counterparty. In addition to time constraint issues inherent in the corporate world, we believe that this option should be resisted at all costs as it will inevitably give rise to numerous interpretative issues when the contract is to be performed, or in case of litigation or arbitration. A typical solution would be to decide on the language that will be binding and then opt for a translation for information purposes only that will be annexed to the contract. It is, in this case, advisable to clearly lay out that in case of controversy, a specific version prevails.

b) Notarial deeds and language choice

A number of European and Latin American countries provide for mandatory authentication of particular types of transactions, such as transfer of real estate or limited company shares. In doing so, the countries pursue disparate goals, such as collecting real estate transfer taxes or making sure parties get independent advice from the notary as to transactions that are particularly important and risky. In asset deals, particular aspects, such as transfer of registered intellectual property rights may have to be authenticated before a notary in a form acceptable for transfer on the relevant register.

In some cases, the choice of a foreign language will not be accepted by the relevant registry. Normally, this problem is solved by moving transfers of this kind to an exhibit to the main contract, which can be in the local language. This can be a problem in Germany due to a statutory provision⁶³ which can

61 Silkenat/Aresty, *supra* (n. 39), p. 401.

62 Although it may not always be advisable, particularly when the time comes to have an agreement with a foreign applicable law judicially enforced.

63 § 311b Abs. 1 Satz 1 BGB. See Rödter/Hötzel/Mueller-Thuns, *Unternehmenskauf*, Munic, 2003 § 5.

lead to nullity of the purchase agreement for an asset deal including real estate unless all related documents are executed in notarial form.⁶⁴

2. Complexity and level of detail in Anglo-Saxon as compared to continental contracts

The sheer length and complexity of the provisions in the Anglo-Saxon contract can change the dynamics of the drafting and negotiating process and even the dynamics of the whole transaction.

One of the authors has described at length how Anglo-Saxon contracts are wordier than German contracts.⁶⁵ Looking at the share purchase agreement or asset purchase agreement only and without considering the ancillary documentation, the authors would estimate that an Anglo-Saxon agreement would typically be 60–100 pages or roughly two to three times longer than a French, German or Dutch domestic agreement. There are several reasons for this. One is the large number of synonyms in the English language and the propensity of Anglo-Saxon draftsmen to write a litany using all of them and then adding the phrase “without limitation”. Second, there is a tendency to regulate matters in great detail which would or at least could be dealt with in Continental jurisdictions by the general law, such as for example the performance of indemnification obligations, duties to mitigate, reduction of damages for comparative negligence, the obligation to perform a contract in good faith. There are conventions to use a number of non-operative clauses known as “boilerplate” such as “the masculine shall include the feminine ...” Finally, there is a propensity for very complicated provisions which could be seen by laymen as overtrading. Typical of these highly complex provisions are the indemnification provisions. Often there are five or six thresholds that a purchaser has to overcome to make an indemnity claim: per claim threshold, overall threshold, cap, and one or two layers of materiality (e.g. “violation of a Material law which has a Material Adverse Effect on the Company ...”) and then a reduction based on purported tax benefits.

Putting the question of transaction costs completely aside, the ability of the lawyers and the parties to concentrate on the contract and understand the interdependencies of the definitions is limited. The incidence of small and large mistakes increases greatly – even geometrically – with the length of the contracts and particularly with complex definitions.⁶⁶ Paradoxically, the

64 Note, however, that the defect is cured when the transfer of the real estate is registered. § 311b Abs. 1 Satz 2 BGB.

65 Hill/King, *supra* (n. 57).

66 For a detailed comparison, see Hill/King, *supra*.

draftsmen of the contracts with the highest risk of serious mistakes attempt to expressly exclude the Continental European doctrines that might correct these mistakes.

Therefore, much of the work of the lawyers' everyday practice involves correcting mistakes which slip into the documentation because the sheer length and detail of the regulation have caused lawyers and parties to lose sight of the individual transaction. Many forms of acquisition documents from large law firms cover the same material in several places. For example, say that the parties agree that the warranties – or particular warranties, such as environmental warranties, shall not be limited by seller's knowledge. The sections in the seller's draft so limiting the warranties and defining "Seller's Knowledge" are then deleted. However, in a seller's draft, such as is commonly presented in connection with a formal or informal auction, the draftsmen try to cover this point in various places for the precise reason that even if the language is taken out in one place, the purchaser might overlook it in another place. For example, there will usually be an innocuous-looking section in the conditions calling for a certificate of the purchaser to the effect that the purchaser does not know of any facts which could form the basis of a breach of representations. There will also typically be a purchaser's representation to this effect. If there is a separate transfer agreement, that agreement might also include such a provision stating that the purchaser is not aware of any such facts. Finally, this qualifier may also be found in the initial interpretation provisions which many lawyers and clients overlook in the review.

It is perhaps a matter of opinion, at what point the exercise stops being a correction of mistakes and becomes an Easter egg hunt for tricky provisions. In a recent program of the American Bar Association on ethical problems in contract drafting,⁶⁷ a number of "tricky drafting" techniques that violate U.S. ethics rules by a seller's lawyer have been identified: (i) making most provisions wildly client-favorable to increase buyer's negotiation costs; (ii) including client-favorable provisions that are void, hoping buyer will not recognize the invalidity; (iii) making broad representations and warranties but burying catch-all exclusions in the exceptions schedule; (iv) hiding important provisions in unexpected parts of the contract and (v) deliberately choosing ambiguous language for some sections to minimize the effect of the client's concessions.⁶⁸ Of course, there is a gray area between "merely" aggressive

67 Goldman, Eric, 'Ethical Issues in Contract Drafting, Seminar on Teaching Contract Skills to Young Lawyers', 4 August 2006 Annual Meeting of ABA Section of Business Law, 48–64.

68 *Ibid.* at 53.

drafting and truly opportunistic “tricky drafting”. For example, a clause that is extremely favorable to one side can be viewed as tricky, if it is repeated in various places in the document in the hope that it would be overlooked in one or the other place and thereby ultimately make its way into the final document.⁶⁹ Likewise, some practitioners consider it tricky that in an agreement without “ring-fencing” of warranties,⁷⁰ qualifications are included in specific warranties which are not in the general warranties. The reason is that without a ring-fencing clause (or similar rule of contract interpretation under the general law), the qualifications in the specific clause negotiated by the seller are negated. Then there are clauses which are tricky in the sense that they

69 As an example, a Seller’s first draft from an international law firm in Germany sent to one of the authors, contained the following sections in the “Indemnification” section: Purchaser shall not be entitled to bring any claim against the Parent and/or the Sellers under or in connection with the Sale Agreements (“**Purchaser’s Claim**”) and Parent and/or the Sellers shall not be liable if and to the extent the underlying facts, circumstances or events forming the basis of Purchaser’s Claim (*anspruchsbegründende Umstände i.S.v. § 199 Abs 1 Nr. 2 BGB*) **are known or deemed known by Purchaser to the extent to which facts or circumstances have been disclosed or which were or could have been known to Purchaser, its representatives or advisors.**

Purchaser confirms that it has had access to and received all requested information about the Sold Business Unit within the comprehensive and in-depth due diligence review undertaken by it prior to the signing of the Sale Agreements. In view thereof, the representations and warranties given by Parent and/or the Sellers are limited to those expressly set out in Section XXX of this Agreement and no other representations, warranties, indemnities or guarantees are given, or any liability assumed, by the Parent and/or the Sellers whether expressly, impliedly or by law. **Any claim of Purchaser and any liability of the Parent and/or the Sellers under the Sale Agreements, including this Section 12.5, is excluded if and to the extent to which facts or circumstances have been disclosed or which were or could have been known to Purchaser, its representatives or advisors.** In particular, but not exclusively, the documents and matters which were made available or disclosed in the data room and those included in the Sale Agreements (including the annexes) and **all matters arising therefrom** or referred to therein, shall be treated as disclosed and known to Purchaser under the Sale Agreements. The same applies with respect to all other information provided to Purchaser, its representatives or advisors in writing, orally or in any other form during the negotiations leading up to the execution and implementation of the Sale Agreements, including the management presentations and question and answer sessions.

70 The idea of “ring-fencing” is to limit the effect of general warranties, for example, compliance with law, to not refer to areas in which warranties are specifically negotiated. See Meany, Michael in *Corporate Counsel’s Guide to Acquisitions and Divestitures*, § 14.006 (2005). For example, if the labor warranty stated that the target complied with applicable labor law, except for the 10 cases of unfair dismissal pending before the tribunal, a ring-fencing clause would prevent a purchaser making a claim for precisely those cases under a general warranty that the target did not violate the law.

change the deal in a surprising way that deviates substantially from market practice or contradict other agreements between the parties.⁷¹

Unethical or not, some of these “tricky drafting” techniques are the daily bread of international M & A practitioners. This is not necessarily the case in the Continental European middle market, where transactions are negotiated and documented in the local language (say in Scandinavia or The Netherlands or with mid-sized firms in Germany or France). The draftsmen in such cases would fear a loss of face in the likely case that the “tricky drafting” came to light. Moreover, it is far more difficult to hide a tricky provision in a 15 page agreement drafted in clear language than in a convoluted 100 page document.

Due to the comparatively high costs of the Anglo-Saxon style, it would be expected that parties would tend towards the more efficient style and away from the inefficient Anglo-Saxon style. The fact that this is usually not the case may point to a market inefficiency or even market-failure in the M & A market.

3. (Lack of) Trust as a reason for complexity and tricky drafting – a cultural problem?

As mentioned above, many of the provisions in M & A documentation are – at least ostensibly – designed to protect the parties from tactical behavior by the other party, for example from the seller selling precisely at the moment in which the business is about to turn down or the seller fearing the buyer will have uncovered something in the due diligence investigation and wants to “sandbag” the seller, i.e. wait to make a claim until after the sale for something for which the seller would not have been willing to agree to a price reduction if the purchaser had disclosed it in the negotiations. Underlying the

71 An example seen by one of the authors in a middle market Swiss-German transaction was a clause in a seller’s first draft stating “The Seller shall not be liable for a breach of warranty pursuant to Section XXX, if disclosure of that breach could have led to a reduction in the purchase price.” Another example, sadly one commonly seen in practice, is a seller’s draft warranty stating that particular financial statements reflect all liabilities, including all contingent and unliquidated liabilities. It can be said with reasonable certainty that this warranty will always be breached in the case of an actively trading company, since financial statements, whether prepared under IFRS, the local implementation of the 4th Company Directive or US GAAP are only permitted to reflect liabilities which have a certain probability and can be quantified in a certain way. Other contingent liabilities (and contingent assets) cannot be reflected. These contingent liabilities exist in a normal trading company in a myriad of areas.

warranties is the theory that the parties will or may behave opportunistically. In the absence of cultural or other constraints – say a long-term supply or other relationship – the parties, while possibly giving lip service to trust and the desire for a long-term relationship, will suspect that the other side will engage in tricky drafting and therefore will not feel constrained from doing so.

Much of the past literature on contracting has focused on particular groups of parties that have been able to achieve trust and efficiencies. This seems to be, for example, the case with diamond merchants who have a large number of transactions with similar counterparties and face a strong risk of retaliation if they engage in opportunistic behavior.⁷² Perhaps in light of the “political correctness” among legal scholars, given the strong stereotypes as to trust and lack thereof in particular countries and regions and among particular groups, there has been little interest in the legal scholarship in cultural differences as influencing M & A negotiations.

This is not the case in the economics scholarship. Since the early-1990s, trust in different cultures has been studied empirically, typically with a “trust experiment” in which all participants get a set amount of money. If they like, they can keep the money or give it to other participants about which they have only certain information. If they do so, the recipient will get a multiple, say 300 %, of the money, that they send. The recipient may, but is not required to, return some or all of the money to the donor. In the trust experiment, the Nash equilibrium is quite simple: each participant keeps his money and, if any is given to him, all of that money. The best result for the participants as a whole, however, is to give away all of the money, since there is a potential for all participants to end up with 300 % of the money they initially received. Participants who do this may, however, be stuck with nothing, if the recipients keep the money.

The trust games show significant differences among cultures and, interestingly, between men and women, as to the degree of trust.⁷³ Not only did some cultures show more trust than other but women generally showed more trust than men, so that groups of women were more successful (took home more money) than men in trust games.

72 See, e.g. Bernstein, Lisa, ‘Opting out of the Legal System: Extralegal Contractual Relations in the Diamond Industry’, 21 *J. Legal Stud.* 115 (1992).

73 Croson, Rachel/Buchan, Nancy, ‘Gender and Culture: International Experimental Evidence from Trust Games’, *Am. Econ Rev.* Vol. 89, pp. 386–391 (1999).

A more recent experiment⁷⁴ showed that the degree of empirically measurable trust is not only different between men and women and among different cultures but also declines, even among residents of a relatively homogenous city such as Zürich, depending on how different the background of the counterparty is. In that experiment, the researchers set up a trust game, where participants could only see the district within Zürich where their counterparty lived. The researchers expected that participants might have a higher or lower level of trust based on the socioeconomic background indicated by the district, for example, district 4 (the red light district) or district 1 (the chic downtown area). This was not the case. Participants from all districts, including the poorer districts, were inclined to trust counterparties from their own district.

This experiment may shed some light on the prevalence of the lengthy Anglo-Saxon contracts and tricky drafting in cross-border M & A: parties from different countries have little trust in each other (as compared to trust in their respective domestic parties) and are constrained from adopting more efficient practices by their lack of trust. Their lack of trust in each other (and the self-interest of their lawyers) condemns them to using lengthy documentation and suffering the consequences of tricky drafting.

4. Why methods to beat back the “imports” of tricky drafting and verbose contracts often fail

One main difference between the subjects in the trust experiments and the parties in an M & A transaction is that the latter have the ability to contract out of the trust dilemma partially or mostly caused by culture – and could potentially agree on sharing the savings. So it certainly requires an explanation as to why they so rarely do so.

One potential method of reducing the cost would be to rely on a choice of law which resulted in surprising clauses being void and providing for a high requirement of good faith. This is not always observed; indeed there seems to be a tendency in cross-border contracts towards a choice of law of English or New York law, which puts far less constraints on opportunism than would, say, Dutch, German or French law in the interpretation of contracts and in correction of opportunistic provisions. If the parties considered it in this way,

74 Falk, Armin/Zehnder, Christian, ‘Trust and Discrimination: A Citywide Experiment’, 2006 (as of September 2006 only available on http://economics.uchicago.edu/pdf/Falk_Trust_4_10_2006.pdf#search=%22%22Trust%20and%20Discrimination%3A%20A%20Citywide%20Experiment%22%22).

the choice of a law that constrained the opportunism would be a way out of the prisoner's dilemma of lack of trust and tricky drafting and could serve to reduce the transaction costs. Sometimes, it is in fact a way out. For example, Dutch parties and lawyers often believe that many tricks will just fail to work if the contract is interpreted in light of "redelijkheid en billijkheid" (a broad doctrine requiring good faith by the parties) under Dutch law. But more often, the parties are in an informational trap: unless the parties are comparative law specialists, they either have to rely on outside lawyers, their own law, as to which logically both parties to a cross border transaction cannot have, or accept a law with few constraints, such as English law, and live with the verbose contracting and sometimes tricky drafting.

In this connection, cultural factors are particularly important in explaining why transactions in English speaking countries in foreign languages and under foreign law are so rare. Large English and U.S. companies rarely agree to documentation in a language other than English, which they consider to be the (only) language of international business. It is even more unusual for them to agree that a transaction in the U.S. or England is documented in a foreign language, even when it would objectively be in their interest to do so.

5. Effect of verbose contract on other aspects of the negotiation

Aside from facilitating tricky drafting, verbose contracts affect the dynamics of who negotiates. Whereas in a concise, easy-to-understand contract, it is possible and frequently desirable that the parties take in the lead in negotiation, the verbose Anglo-Saxon drafting style tends to put the lawyers in the forefront, since only very experienced parties are able to see their way through the complex provisions. Also, the longer length of the negotiations and the fact that the same issues come up several times tend to foster some of the less friendly negotiation tactics (aggressive styles, raising false issues, etc.)

IV. National sensibilities and legislation of cross border transactions

The different cultural aspects become particularly apparent in large, high profile cross-border transactions, such as the EON-Endesa transaction at the time of the writing of this paper, in which the Spanish government took a number of steps that have been criticized as being protectionist and nationalistic. The very different cultural attitudes towards inbound cross-border M & A may have an impact on such cross border transactions. This is reflected by the extent to which a particular country uses its legislation, and more generally, its ability to influence the regular course of a transaction through

the use of political interventionism in order to control, or more generally, limit the ownership of its domestic companies by foreign investors.

1. Openness – examples of England and Germany

Despite saber rattling in Germany by Social Democratic Politicians, one of whom compared Anglo-Saxon private equity forms to a “swarm of locusts”, the environment in Germany, as well as in England, has been very friendly to inbound foreign investment, whether it be the current offers for the local stock exchanges or for the largest industrial companies in the country. The entire English auto manufacturing industry is in foreign hands and the London Stock Exchange – an enormous national symbol in England – was sold to the NASDAQ with hardly any protectionist sentiment. As these examples show, the UK has clearly a more liberal attitude towards foreign ownership and does not favor the emergence of national champions.⁷⁵

The same is the case in Germany where some of the largest companies in the country (including Mannesmann, formerly in the DAX 30) have been acquired by foreign companies. It is also more protected by cross shareholdings between large German companies, and by the role of German banks as large shareholders. In Germany, there does not seem to be an active doctrine of interventionism towards the creation of national champions, but more often, attempts to influence and address potential redundancy consequences.

2. Interventionism: the French “counter” example

France has showed that that it uses both aspects of the interventionism: a passive interventionism through the enactment of legislation for the protection of sensitive sectors and an active interventionism used to protect and favor the emergence of “national champions”.

We will not be focusing on French passive interventionism as we do not believe that it evidences any particular cultural traits. France,⁷⁶ like most if not

75 Even electricity and water companies have been taken over (Powergen and Thames Water were acquired by RWE). The car making company Rover has been dismantled and sold in majority to Chinese investors.

76 The French government and administration have very limited legal means available enabling them to veto a transaction. In 2004, the legislature amended the French monetary and financial code and granted the government a formal veto right with respect to foreign investments in French businesses that could harm French public

all countries has a legislation protecting investments by foreigners in sensitive sectors. Restrictions on foreign ownership in the media is also widespread and not a good indicator of cultural differences.⁷⁷

order, public security, or national defence interests. The adoption of the decree dated December, 31 2005 (the “Decree”), which was required by the 2004 regulation, results in an extension of the number of “sensitive” sectors when compared to the previous regulation. Depending on the activity and nationality of the target company, a foreign buyer may have to take into consideration the legislation controlling foreign investments. The Decree creates three different classes of investments: investments by non-EU entities (for this purpose, French authorities would look to the nationality of the ultimate controlling shareholder); investments by EU entities in a “branch of activity” of a company having its registered office in France; and investments by EU entities consisting in acquiring “control” over a company having its registered office in France. A different list of “sensitive” industries applies to each class of investment. Not surprisingly, the list of industries for non-EU investments is the broadest, including eleven categories such as gaming, life science research in anti-terrorist vaccines, and more traditional defence-related sectors such as encryption. For EU investments consisting in the acquisition of a “branch of activity”, the list of industries includes the same eleven sectors as those mentioned in the list for non-EU investments, but the scope of each sector is more narrowly defined.¹⁴ For EU investments consisting in the acquisition of “control” over a company having its registered office in France, the list includes only four items: (i) encryption, (ii) companies holding classified defence secrets, (iii) companies involved in arms research, production or sale, and (iv) companies having contracts with the French Ministry of Defence to develop or supply any of the foregoing.

With respect to foreign investments in French “strategic” sectors resulting from the Decree, the EU Commission sent a letter of formal notice in April 2006 claiming that France was breaching the Treaty rules on free movement of capital (Article 56) and the right of establishment (Article 43). France was asked to clarify why companies established in the EU but under the control of third country investors could be submitted to the more stringent procedure applicable to third-country companies, when a company legally and genuinely established in a Member State should normally be treated as a national of that Member State. Moreover, the Commission also raised concerns on the fact that investments in companies would require authorisation because only a marginal share of the turnover originates from activities that relate to public policy, public security, and national defence. Finally, the Commission considers that the inclusion of casinos within the scope of the Decree is unsatisfactory, given that casinos should be covered by the appropriate transposition of the Money Laundering Directive (2005/60/CE). France answered in early June and the EU Commission officially requested on 12 October 2006 that the French Government amend the Decree.

⁷⁷ The restrictions on foreign ownership of French language press come from the Ordinance of August 26, 1944 whose main objective, following the occupation, was to ensure a pluralism, transparency and lack of foreign influence on French language publications. The French Law Act no. 86–897 of August 1, 1986 (the “1986 Law”) has redefined the regime on restrictions on foreign ownership. Its article 7 provides that:

“In the public debate, ‘economic patriotism’ is used as a general euphemism for a wide array of protectionist and industrial policy measures.”⁷⁸

“Subject to international undertakings entered into by France and providing for either a national treatment clause or a reciprocity clause in the field of press, foreigners cannot, from the publication of the present law, carry out an acquisition leading to the holding directly or indirectly of an interest exceeding twenty percent (20 %) of the share capital or voting rights in a company that publishes a French-language publication”. The 1986 Law does not provide for a prior approval or other exemption process. A breach of the requirements of the 1986 Law is criminally sanctioned by a fine of € 30,000 and/or one year’s imprisonment. Some of the key elements of the restriction provided for by article 7 of the 1986 Law remain unclear, and to our knowledge, no case law has ever been developed, which is most probably due to the risk of criminal sanction. A surprising restriction, created by the 1986 Law, comes from the fact that the prohibition covers all French language publications without using the distinction created by the Ordinance of August 26, 1944 on the organization of French press between, “publications of general and political information”, and “recreational publications”. In other words, the acquisition by a foreign company of more than a 20 % interest in a French company publishing French language recreational magazines is forbidden. This anomaly has recently been the subject of some attention, but has not yet given rise to an amendment. Another surprising feature of the 1986 Law is the definition of “foreigner”. Under the 1986 Law, a “company is considered as foreign where the majority of its share capital or voting rights is held by foreigners or by any organization where the majority of its managers are foreigners”. French legal authors consider that this provision should be read as a look through provision up until the ultimate beneficial owners, and that therefore the indirect holding of 20% by foreigners falls within the scope of the 1986 Law. This would therefore mean that the acquisition by an EU company owned by non-EU shareholders would fall within the prohibition of the 1986 Law. Although this provision of the 1986 Law is certainly in breach of articles 43 and 48 of the EC Treaty, no company has, to our knowledge, tried to challenge it in court. The 1986 Law however does not specifically prohibit the setting-up of French language publications by foreigners since it only prohibits acquisitions leading to the holding of more than 20 % of the share capital or of the voting rights of a company publishing existing French-language publication. It seems that it does not either prohibit the acquisition of French language publications through assets deals, since it only refers to the acquisition “leading to the holding of more than 20 % of the share capital or voting rights in a company”. Although it could be argued that these identified loopholes are an attempt to circumvent the spirit that presided to the drafting and adoption of the 1986 Law, legal commentators generally believe that given the criminal nature of the sanction, the provisions of the 1986 Law must be strictly interpreted.

The 1986 Law should be amended to comply with EU law, to exclude from its scope recreational publications and to cover all types of acquisitions and not only share deals. Such amendments could create a welcomed influx of investments in the French press sector, and increase competition for ownership, which could probably lead to more attractive pricings for sellers.

78 Economic Patriotism, ‘New game in industrial policy?’, Deutsche Bank Research June 14, 2006.

France⁷⁹ has a very strong⁸⁰ interventionist attitude aimed at protecting “national champions” who receive political assistance, and financial support. This attitude is however not evidenced for small or mid-sized businesses.⁸¹ In the summer of 2005, the French Prime Minister Dominique de Villepin was quoted saying,

.... I wish to reassemble all our energies around a true economic patriotism. I know that this is not part of the usual language but it is about ... defending France and what is French.

This is how most of the politics in France reacted to the rumored threat of a takeover on Danone by PepsiCo. Even though 75 % of Danone’s turnover is made outside of France and Danone’s foreign shareholder ownership is well above 40 %, the dairy products making company was deemed to be a “strategic sector” in itself. When Renault was rumored to be on the target list of a couple of foreign companies, the government implemented tailor made amendments to the French Financial and Monetary Code.⁸² Another illustration of this interventionist attitude was confirmed in early 2006 when the French government announced the proposed merger between Suez and Gaz de France to counter a potential hostile takeover offer by the Italian company Enel.⁸³ This economic patriotism was also seen in the opposition voiced by the French government to the takeover launched by Mittal Steel on the French company Arcelor, even though the shareholding of Mittal Steel is mainly European, and Mittal Steel is a Dutch company. Economic patriotism was also witnessed in the heated debates that surrounded the implementation

79 Landier, Augustin/Thesmar, David, *Quel patriotisme économique au XXI^{ème} siècle*, Institut Montaigne, December 2005.

80 It may be particularly strong in France due to the personnel links between politics and industry forming part of a single elite network.

81 JP Nobile/G. Claverie, “*Patriotisme économique: et les PME?*”, La Tribune, May 10, 2006.

82 Article 433-3 IV of the French Monetary and Financial Code provides that the takeover offer made on a French listed company must also launch an offer on a company listed on a foreign exchange when at least one third of its share capital or voting rights is held by the target company and when this shareholding constitutes an “essential part of its assets”. It is generally considered that this amendment was adopted to protect Renault. If a takeover offer is made on Renault (valued at 20 billion euros), the offeror would also have to launch a public offer on Nissan (valued at 60 billion euros), which would thereby increase dramatically the cost of the takeover. See Faugérolas, Laurent/Sce-mama, Jeremy, ‘L’ offre publique obligatoire étendue à la filiale étrangère de la cible (article 34 de la loi Breton)’, Bulletin Joly Bourse, November 1, 2005 n° 6, p. 705.

83 Les Echos, March, 23, 2006.

of the takeover directive and in the set of measures that were adopted to counter takeovers by foreign companies.⁸⁴

This attitude is to be contrasted with the general applause witnessed when Sanofi-Synthélabo purchased Aventis, or more recently when Pernod Ricard, together with Fortune Brands, acquired the UK company Allied Domecq, or when Gaz de France recently followed an aggressive acquisitive strategy outside of France.

Other European countries have also witnessed these protectionist and industrial policy measures.⁸⁵ Although the UK and Germany have a more liberal attitude towards foreign ownership, some concerns were raised however when Gaz Prom was rumored to acquire a stake in Centrica (British Gas); also, with the recent tax reforms and the increased activism of hedge funds, in Germany too the need for government intervention has been an issue at times, for example, with the proposed merger of the French pharmaceutical company Aventis with Hoechst-AG, and the French chemicals group Rhone-Poulenc.⁸⁶ In Spain, interventionism seems to be well alive with the attempted acquisitions by EDF of Hidrocantabrico sold to the Portuguese EDP, or by E.ON of Endesa and Italy, with the intervention of the Italian central bank against the purchase by BBVA and ABN AMRO of BNL and Banca Antonveneta.

EU law clearly does not favor economic patriotism, and more generally the blossoming of national protectionisms, which directly contradict the fundamental principles underlying the single European market.⁸⁷ One of the ways which the European authorities have reacted to the multiplication of cross border tender offers is the adoption of the takeover directive. In addition to leveling the regulatory playing field, through the implementation of the reciprocity clause, European companies are now in a better position to defend themselves against hostile foreign takeover offers with comparable weapons.

84 De Girard, Pierre-Menno/Bénézant, Stéphane, 'Offres publiques d'acquisition: nouvel enjeu du patriotisme économique', *Décideurs: Stratégie, Finance et Droit*, December 2005, p. 37.

85 Economic Patriotism, 'New game in industrial policy?', *Deutsche Bank Research* 14 June 2006.

86 See also the large shareholding acquired by Porsche in Volkswagen, see also Schall, Alexander/Miles, Lilian/Goulding, Simon, 'Promoting an Inclusive Approach on the Part of Directors: the UK and German Positions', *Journal of Corporate Law Studies* 299 (2006) at 324.

87 See section [4B)i2)] in respect of the letter sent by the EU Commission to France following the adoption of the Decree on "sensitive sectors".

This interventionist attitude is usually justified by a concern over domestic jobs and the protection of the sectors that are deemed strategic⁸⁸ for a nation against acquisitions by foreign companies. It cannot indeed be denied that the ownership of production assets and the localization of the decision making centers are highly symbolic. We believe that governments should not interfere in the corporate decision-making through the use of “defensive” patriotic measures. Only the shareholders of a target company should be empowered to tender their shares to an offer or not. Patriotism creates neither employment nor growth in the long run. Although the threat of a public takeover creates incentives for managers to create value for shareholders, it is not doubted that patriotism increases value for shareholders of target companies. For example, Arcelor shareholders saw the value of their shares increase from €15.12 to €21.27 in less than six months.⁸⁹ It also protects managers against dismissals. Although it is fairly difficult to demonstrate, we believe and have witnessed that patriotism also creates a disincentive for foreign companies to invest in French listed companies thereby affecting France’s competitiveness.⁹⁰ Studies made on American, Swedish and UK companies demonstrate that the taking of control by a foreign shareholders results in an increased productivity of the target company resulting generally in higher salaries for employees and in average not resulting from redundancies.⁹¹ Patriotism creates the illusion that a government has the weapons to intervene and block a tender offer.⁹² This was particularly visible when the French Prime Minister declared that he would do “everything” in his power to counter the potential offer by PepsiCo on Danone. It also entertains the feeling among citizens that takeovers are dangerous for employment and generally for the country.⁹³

Companies have a number of weapons to defend themselves against potential threats: shareholders’ rights plans, execution of shareholders’ agreements, use of certain legal corporate forms such as a *société en commandite par actions*,

88 This is particularly relevant for utilities industries, such as gas, water and electricity.

89 www.arcelor.com

90 In 2005, foreign investments in France reached 25 billion euros but have decreased 44 % compared to 2004 (Yves de Kerdrel, *Le Figaro*, 7 March 2006).

91 Landier/Thesmar, *supra* (n. 78).

92 Although it is to be noted that the Caisse des Dépôts et Consignations has recently been playing a more active role in the economic patriotism by taking stakes in a number of threatened companies (see for example Euronext, Eiffage or EADS). ‘La Caisse des dépôts, pilier du patriotisme économique’, *La Tribune*, 14 April 2006.

93 Laine, Mathieu/Arvis, Christophe, ‘Les limites du patriotisme économique’, *Les Echos*, 23 Sept. 2005.

limitation on voting rights,⁹⁴ shares with double voting rights,⁹⁵ acquisition by a potential target of a subsidiary conducting business in a regulated sector (e.g. defence, press, bank, insurance, health, etc), which will lead to the prior authorization of the relevant authority especially where the issuer is not a French investor, use of Pac-Man defences, addition of a change of control provision in the main commercial or financial agreements of the target company. It is true however that the adoption of defence mechanisms is restricted by the duty to comply with the target company's corporate interest (*intérêt social*), the duty to treat all shareholders equally, the prohibition of "absolute" defences and the requirement to comply with the principle of a level playing field between bidders.

Although shareholders should have the last word in case of a takeover, the government still has the ability to push for another type of positive interventionism, aimed at increasing France's attractiveness with for example a stable yet flexible legal system which would favor investments, education and the labor market and reduce bureaucracy.⁹⁶ The tax system should also be simplified and aimed at incentivising employee shareholding. The fairly small portion of French shareholders in French companies may be at the heart of the reason why defensive patriotism is blossoming in France. Almost half of the share capital of French listed companies is owned by foreign investors,⁹⁷ which is to be contrasted with the one third foreign ownership of the FTSE 100 companies in the UK.⁹⁸ In the absence of proper incentives and in particular the lack of private pension funds, French shareholders are indeed disincentivized to properly analyze the high costs involved in defensive patriotism, and reap the benefits resulting from capitalism.⁹⁹

94 The articles of association of the target company can also limit the number of shares an individual shareholder may be able to vote, irrespective of the actual number of shares held. Customarily, articles that limit voting rights provide for such limitations to become ineffective once a shareholder exceeds a particular share ownership threshold (typically 3/4).

95 The target company's articles of association or an extraordinary shareholders' meeting may provide for double-voting rights to attach to shares held for a certain period of time (at least two years). Since the double-voting rights expire once the underlying shares are transferred to a third party, they effectively preclude the offeror from benefiting from them post-closing.

96 Fressoz, Françoise, 'L'étroite frontière du patriotisme économique', *Les Echos*, 14 March, 2006.

97 *Le Monde*, 25 mai 2006, p. 15.

98 Economic Patriotism, 'New game in industrial policy?', *Deutsche Bank Research* 14 June 2006.

99 Landier/Thesmar, *supra* (n. 78). This situation is to be contrasted with the measures taken in the 70's in the United States to spread the ownership of shares.

V. Conclusion

Despite the discourses on globalization and universalism, cultural differences play an important part since they shape the values, thoughts and behaviors of individuals. This article has attempted to show how cultural differences should be taken into account as they often dictate behaviors of parties involved in a cross border negotiated transaction.¹⁰⁰

Protectionism in the macroeconomic picture shows some parallel to the opportunistic approach in the microeconomics of an individual deal. Both are normally only optimal in a single game (i.e. negotiation or business dealing) that is not repeated. In an M & A market where 50 % or more of the transactions are cross border and large transactions are initiated by companies from the same countries (e.g. France or Spain) espousing protectionism, there is a real question as to whether protectionism or openness is really in the national interest, given the effect on future potential transactions. It doesn't take much prescience to predict that there will be large takeovers by French companies in the future in the very countries whose companies are involved in the disputed French takeovers. Although the negotiation technique of the French politicians as to the macroeconomic M & A problem is very similar (possibly path-dependent or otherwise culturally driven) to the negotiation technique thought to be typical of French dealmakers in negotiated transactions, we query whether this really serves French (or European) interests and whether a more integrative style such as the Harvard method might yield, in the long run, better results, both politically and in individual deals.

100 Barmeyer, Christoph/Mayrhofer, Ulrike, 'Le management interculturel: facteur de réussite des fusions acquisitions internationales?', *Gérer et Comprendre*, Dec. 2002, n° 70.