# Cautions and Considerations in International Mergers and Acquisitions

Michael E. Zeller

*Member*

Moore & Van Allen, PLLC

ASPATORE

**Introduction**

As globalization of business has increased and the US dollar has remained relatively soft, M&A activity is now occurring on a much larger scale. Over the past several years, many companies, particularly foreign entities, have entered into international M&A transactions to accomplish foreign direct investment in lieu of commencing greenfield operations. Due to the weak US dollar, acquisitions in the United States by foreign entities are currently very attractive. Despite the weak dollar, there are still many cross-border transactions taking place with a US purchaser. This chapter will focus primarily on international M&A transactions between US entities and European entities.

The year 2007 marked the height of international M&A transactions— approximately $1.7 trillion. The financial crisis and subsequent recession struck in 2008, resulting in a material drop in both domestic and international M&A activity. Since the initial downturn in the economy, however, there has been a significant rise in international M&A transactions commencing in 2009 and rising steadily with transactions of approximately $1 trillion in value closed in 2011.[1] In order for parties to successfully accomplish these transactions beyond just closing the transaction, there are a number of issues—both legal and non-legal—that should be addressed in connection with consummation of the transaction and post-closing activities (e.g., conducting due diligence with a focus on labor and employment issues, environmental issues, intellectual property issues, tax issues, and cultural and/or language differences).

**Trends to Note**

There appears to be a growing trend toward international M&A transactions in large part due to the globalization of business. Currency valuation is an additional driving factor. Recent transactions that have been reported across various sectors include, for example, Google's proposed acquisition of the cellphone maker Motorola Mobility; Hana Financial Group Inc.'s purchase of the American lending subsidiaries of Korea Exchange Bank, which would complete a long-stalled $3.5 billion takeover of the company from private equity firm Lone Star Funds; Singaporean agricultural processor Olam International Ltd.'s purchase of Nigerian biscuit and candy maker Titanium Holding Company SA for $167 million in order to seize on rapid growth in West African consumer markets; and the failed merger of NYSE Euronext with Deutsche Börse AG.

The world has become a much smaller place from a business perspective, and as a result, international M&A transactions are similar to domestic transactions. The main issues that arise in a domestic transaction (e.g., labor and employment, environment, intellectual property) are, however, further complicated by the application of foreign laws and need to be taken into consideration when contemplating an international M&A transaction.

**International versus Domestic M&A**

From my experience working for a German law firm and then a US law firm, I have concluded that international M&A deals differ from domestic transactions due not only to the different legal systems but also to cultural differences. Many European countries have precise statutory provisions that make drafting much simpler than what it is in the United States. For example, various topics are governed exclusively by statute whereas in the United States we would also need to look at case law. At the same time, the way a law firm in

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[1] *International Mergers and Acquisitions Surge in 2011,* Investment News, Issue 16, p. 1. (Oct. 2011) (A publication of the Investment Division – Secretariat of the OECD Investment Committee).

the United Kingdom, Germany, or the Netherlands would draft a purchase agreement is often structurally different from the way a US firm would prepare the same document.

In my opinion, the largest and perhaps most obvious change in the international M&A arena is the prevalence of cross-border transactions and law firms expanding their worldwide reach by establishing offices around the world. As one example, Fulbright & Jaworski LLP and Pillsbury Winthrop Shaw Pittman LLP are discussing a possible merger that would create an international megafirm with more than 1,500 lawyers[2]. Groups like Globalaw® also enable law firms from around the world to function much like one large law firm without being a combined legal entity. Networks like these allow firms—both small and large, but regional—in countries around the world to have a presence and access to resources in other countries and therefore compete on a similar level to the mega-international firms. While these groups have existed for years, the growth over the last five years has demonstrably improved their ability to participate in the global practice of law.

**Preparing for an International M&A Deal**

It is the role of US and local counsel to advise the client on the impact of the respective laws that may apply to the transaction. Depending on what the client wants to accomplish, one country's law may be chosen over another to accomplish a different structure, for example, with regard to a breach and the application of a penalty versus liquidated damages. On a recent transaction, a German client was acquiring a US entity from a Belgian entity. Because the client was acquiring the stock of the US entity and there were significant potential risks regarding environmental liabilities, we advised that US law should govern the transaction ; however, the client and the seller ultimately agreed on the application of German law, because both parties were located in Europe and they ultimately felt more comfortable with the German legal system. Although US law may be preferable in certain circumstances, it is the consensus of European entities that the US legal system is a veritable nightmare once litigation is involved.

Some of the greatest compliance challenges arise for companies subject to International Traffic in Arms Regulations (ITAR). These regulations are complex and generally require outside counsel that specialize in this practice area.

Immigration is another area of concern that a company needs to be educated on and stay updated in, to avoid compliance difficulties and challenges. If a US company acquires a foreign company with US operations, the change in control could have an impact on the immigration status of the target company's employees in the United States. Many US companies fail to properly comply with US immigration laws (e.g., failure to keep proper I-9 records, etc.). Due diligence should include a complete inquiry on a US target's compliance with immigration laws.

Additionally, laws in various jurisdictions are extremely protective of distributors or agents. In Belgium, for example, if a company terminates a distributor without cause, the terminating company could be subject to damages equal to three years of sales. In the United Arab Emirates, once an agency agreement is registered, it is essentially impossible to terminate that relationship without the consent of the agent.

US companies acquiring foreign targets need to be cognizant of the application of ITAR, Foreign Corrupt Practices Act (FCPA), Dodd-Frank Act, the UK Bribery Act, and similar laws. The Hart-Scott-Rodino Act

[2] Law360 International Trade e-mail, Feb. 13, 2012.

may also be applicable to international M&A transactions and, if so, it is likely that the merger authorities of other jurisdictions will also analyze the transaction.

Corporate corruption has been in the news over the last several years and as a result, there has been a new focus on corruption through the further development and enforcement of various regulations and laws. For example, the enforcement of the UK Bribery Act—which was just amended in 2011—and the FCPA have increased significantly over the last five years and is a regular topic in news reports around the world. For example, in April 2010, *Time Magazine* published an article online titled "U.S. Cashes in on Corporate Corruption Overseas."[3] See also "The Transatlantic Anti-Corruption Arsenal: the FCPA and the Bribery Act."[4]

**Considerations Before Initiating the M&A**

When counsel is approached by his or her client that the client is contemplating an international M&A transaction, counsel must advise the client on the various considerations to be taken into account upon commencing such a process.

*Beginning the Process of Due Diligence*

The following questions should be asked from a process perspective if the company is selling:

1. Should the company engage an investment bank to assist the board with the sale and to drive value or does the company have sufficient internal resources that can effectively serve in this role?
2. Is the company prepared for the due diligence process? How will due diligence materials be prepared (i.e., online data room or physical data room)?
3. Who at the company is going to drive the process?
4. Does anyone at the company speak the language of the foreign target?
5. Will local counsel be engaged? If so, what role will local counsel play?

The following questions should be asked from a process perspective if the company is buying:

1. Should the company engage an investment bank on a buy-side engagement? Investment banks may be able to identify prospective targets that the company may not have otherwise considered.
2. Who for the company is going to oversee the due diligence process?
3. Does anyone at the company speak the language of the foreign target?
4. Will local counsel be engaged? If so, what role is local counsel to play?

Obviously, these questions overlap, but they can have significantly different answers depending on the nature of the deal. Due diligence has increased considerably over the last decade and has become one of, if not the most, important component in an M&A transaction—international or domestic—because it provides the

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[3] *U.S. Cashes In on Corporate Corruption Overseas,* TIME (Apr. 7, 2010), *http://www.time.com/time/business/article/0,8599,1977526,00.html*

[4] Davenport Lyons (UK member of Globalaw) and Day Pitney LLP (Massachusetts, US member of Globalaw), *http://www.davenportlyons.com/legal-services/articles/the_transatlantic_anti_corruption_ arsenal_the_fcpa_and_the_bribery_act/*

foundation for negotiating the definitive purchase agreement. Without full disclosure, the parties are not on a level playing field for negotiating the transaction.

*The Importance of Efficiency in Due Diligence and Maintaining an Advantage*

In a recent transaction where our client purchased a US company, seller's counsel in Belgium created an online data room. No one was permitted to print or otherwise copy the documents, which made the diligence process extremely difficult. The costs of due diligence were increased by at least 30 percent due to the fact that the lawyers reviewing the due diligence materials had to spend more time looking at the computer screen and taking copious amounts of notes in lieu of being able to print documents and simply annotate them. Legal counsel should coordinate with whomever is going to be responsible for the due diligence process (buy-side or sell-side), so that it can be done in the most efficient manner, unlike the example provided above.

I have found it significantly advantageous to be able to speak German when working on a transaction with German speakers on the other side of the transaction. Due to the general misconception that Americans are xenophobic and unwilling to learn foreign languages because English is the worldwide business language, it has been a material asset for me to understand opposing counsel speaking German when they were unaware that I speak the language. Additionally, having an understanding of the underlying law of the foreign country can have untold benefits.

Establishing a solid relationship with local counsel will also reap rewards in the transaction process. Local counsel are aware of all of the local customs and cultural issues that could affect negotiations (e.g., from the delivery of a business card to whether you can put your feet on the table without causing offense to the party on the other side of the table).

*Additional Business Considerations and the Five-Cs Framework*

When seeking an international merger or acquisition, the following business issues should also be considered:

1. How will it improve their competitive standing?
2. How will it enhance their technology?
3. How will it serve to upgrade their offerings?
4. How will it expand their customer base?
5. Other factors that should be considered include: costs of labor; delivery costs; free trade zones, etc.

Of course, a company's board of directors should address these five basic questions when assessing the viability of any transaction, whether domestic or international. In an international M&A transaction, however, the board must also consider cultural aspects that could affect the answers to those questions. Professor Daniel Rottig, in his whitepaper, Successfully Managing International Mergers and Acquisitions: A Descriptive Framework[5], describes "the Five-Cs Framework": control, connection, cross-cultural communication, and cultural due diligence lead to combining cultures successfully, which in turn leads to international acquisition performance.

Each component of the five-Cs is critical to the success of a transaction—which should be evaluated not only by closing a deal but more importantly by the functioning of the resultant business entity. As Professor Rottig

[5] Rottig, Daniel, *Successfully Managing International Mergers and Acquisitions: A Descriptive Framework,* International Business: Research Teaching and Practice, p. 99 (2007 1(1)).

notes: "Cultural differences may even constitute an opportunity for MNCs [multinational corporations] to achieve a global competitive advantage. Through acquisitions in culturally distant markets, an MNC may be able to access crucial resources and capabilities that are not available in culturally similar markets. Researchers have suggested that through internationalization into distant foreign markets, MNCs may expand their knowledge bases, access innovative technological capabilities, and gain valuable international experience. Furthermore, researchers have noted that expansion into distant international markets allows MNCs to deal with a diverse set of competitors and customers, which may create a significant competitive advantage over purely domestic firms and allow MNCs to preempt rivals."[6]

International practitioners must be in a position to support their clients in evaluating the Five-Cs Framework throughout an international M&A transaction. This framework has a material impact on the underlying business decisions and determinations that must be made by management and will ultimately contribute to a successful transaction or one that is not implemented property. International legal practitioners work year after year with various companies and investment bankers in negotiating transactions, which gives them insight into many different transactions across many different industries and cultures. Therefore, lawyers should be engaged in the process as early as possible, because they can provide guidance with respect to various risks associated with an international M&A transaction, especially in light of the Five-Cs Framework.

*Potential Risks with International M&A Transactions*

Putting aside the cultural risks, the general risks associated with an international M&A deal are similar to a domestic transaction. The risks with respect to labor, employment, tax, environmental, and intellectual property, however, can become more substantial because of applicable foreign laws. While certainly not limited to international M&A transactions, lawyers and their clients need to take into account the potential application of the International Traffic in Arms Regulations (ITAR), the Foreign Corrupt Practices Act (FCP"), the Dodd-Frank Act, the UK Bribery Act, and similar laws.

Industries that are highly dependent on human capital will be significantly impacted by labor and employment issues. In the technology sector and some manufacturing industries with proprietary manufacturing processes or patented products, intellectual property issues will be significant and will require special due diligence and drafting. Distribution-based businesses may be subject to risks associated with terminating a distributor.

Differences Between US and European Laws and Regulations

Many European countries have laws that are protective of employees, which must be taken into consideration in the event layoffs are contemplated in connection with an acquisition by a US client and discussed with the target during negotiations. There are often substantial costs associated with such layoffs that are far in excess of which US companies are accustomed.

For example, in the United States, companies are subject to the Worker Adjustment and Retraining Notification Act (WARN Act). The WARN Act protects workers, their families, and communities by requiring most employers with one hundred or more employees to provide notification sixty calendar days in advance of plant closings and mass layoffs. Employees entitled to notice under the WARN Act include managers and supervisors, as well as hourly and salaried employees. The WARN Act requires that notice also be given to employees' representatives, the local chief elected official, and the state dislocated worker unit.

[6] *Id.* at p. 103.

The advance notice gives workers and their families some transition time to adjust to the prospective loss of employment, to seek and obtain other jobs, and, if necessary, to enter skill training or retraining that will allow these workers to compete successfully in the job market.

Although the United States has many statutes protective of US employees—including the WARN Act, the Family Medical Leave Act, and the Fair Labor Standards Act—those statutes can in fact pale in comparison to the employment laws of foreign jurisdictions. In Germany, for example, the relationship between employers and employees is highly regulated by legislation, collective agreements, and individual employment agreements. The key legislation in Germany consists of the German Civil Code (*Bürgerliches Gesetzbuch*), the Works Constitution and Employees' Representation Act (*Betriebsverfassungsgesetz*), the Act on Collective Agreements/Collective Bargaining Contracts Act (*Tarifvertragsgesetz*), and the German Employment Protection Act (*Kündigungsschutzgesetz*).

Under German labor and employment law, employees who work a normal five-day week have a statutory claim for twenty days (i.e., four weeks) of vacation. It is more typical, however, for an employee to receive between twenty-five and thirty vacation days per calendar year, depending on seniority and the type of business. This is drastically different from vacation policies in the United States and would need to be taken into consideration with respect to calculating the costs of operating the target going forward as well as dealing with any disparities between US employees and German employees.

There are other significant differences such as: female employees are entitled to full paid maternity leave, starting no later than six weeks before the expected due date and ending eight weeks after childbirth; both male and female employees are entitled to a maximum of three years uncompensated parental leave, after which time the employer must offer an adequate position to the employee; and mandatory social security payments, which amount to approximately 22 percent of the employees' gross salary and must be paid by both the employer and the employee.

For companies that have more than five employees, the employees may elect a works council (*Betriebsrat*). The works council plays an important role in German labor and employment law as the works council represents the employees and negotiates, cooperates, and consults with the employer and its management team in various situations (e.g., hiring of new employees, changes to the place of business, shut down of the business, mass layoffs).

German employment termination law is regulated by various codes and is intended to give the employee maximum protection against unfair dismissal. For example, the employer must observe the applicable notice period, which is ordinarily determined by law—between four weeks and seven months, depending upon the length of employment. If the employer and the employee have mutually agreed upon a longer contractual notice period, the longer contractual notice period will prevail. Any agreement on a notice period that is shorter than the applicable statutory notice period will be invalid. Generally, termination of employment can only be effected as of the end German Employment Protection Act (*Kündigungsschutzgesetz*) calendar month. The employer must therefore keep the effective date of employment termination in mind when calculating when to deliver the notice of termination.[7]

[7] http://www.nrwinvest.com/Business_Guide_englisch/Employees_and_social_security/Termination_of_Employment1/index.php

The German Termination Protection Act restricts termination of employment if the employee has been employed for more than six months when the notice of termination is given. Notably, this act applies to companies that employ more than five employees, which is significantly more stringent than the WARN Act.

**Tax Considerations**

The US tax consequence of a merger or acquisition can vary significantly based on the type of transaction and the legal form of entities involved in the transaction. The primary consideration is whether the merger or acquisition will qualify as a tax free or taxable transaction.

In certain circumstances, there may be a desire for the merger to be taxable. This is especially true if the acquired target has significant tax loss carry forward. Often the result of a taxable transaction is to allow the acquirer to amortize, for tax purposes, the purchase price of the acquired entity. However, in a non-taxable merger this option is not available.

Under US tax law there are multiple variations on the merger of two entities with each having their own unique tax consequences. The primary issue with the merger of a US corporation into a foreign corporation is the set of rules under I.R.C. § 367.

I.R.C. § 367 generally provides that transfers to a foreign corporation do not qualify for tax-free treatment ; however, the exception to the general rule allows the traditional merger transaction of a US corporation (acquired) into a foreign corporation (acquiring) to defer any taxable gain as long as the transaction meets the requirements of the regulation under §1.367(a)-8. These regulations require every 5 percent or greater shareholder to enter into a five-year gain recognition agreement (GRA). The GRA requires the taxpayer to certify over the next five tax years that a disposition or other trigger event has not occurred. In the event a disposition has occurred, the GRA requires the taxpayer to recognize the gain that was realized, but it is not recognized on the initial transfer as part of the merger transaction. The taxpayer must also recognize gain on a partial disposition based on a proportionate amount. The amount is based on the fair market value of the disposed assets to the fair market value of all assets transferred subject to the GRA.

Additionally, a foreign buyer needs to consider the structure through which it will acquire a target in the United States. While limited liability companies have garnered much favor over the last many years, foreign entities need to be cognizant of the fact that, if the limited liability company is taxed as a partnership and the foreign entity acquires the membership interests directly, the foreign entity could be subject to branch profits tax, which could have a material adverse effect from a tax perspective. Likewise, if the limited liability structure is treated as a partnership for US tax purposes, I.R.C. § 1446 requires the LLC to withhold and pay tax on the foreign partners' distributive share of income at the highest applicable US tax rate. Withholding is required whether the foreign partner actually receives a distribution of profits from the LLC. Furthermore, many countries do not recognize LLCs as a distinct entity, which can result in unintended complexity.

Finally, before any cross-border transaction is completed, a thorough analysis of the tax treaties between the countries should be performed.

**Attaining Success in the M&A Deal**

The seasoned legal practitioner will recognize both the process issues and the pitfalls that can affect a transaction. It is important for counsel to manage the expectations of their clients. For example, in the event you are representing individuals who are selling their business to an international strategic partner and your clients have never been involved in such a transaction before, you need to educate them on the entire process and the concept of deal fatigue, among other things. They will likely experience this because they have never gone through the due diligence process and the negotiation of an exhaustive purchase agreement while continuing to run their business. Although this is not entirely different from a domestic transaction, with cultural differences as well as language and time differences complicating matters, the process can be exhausting even for a successful businessperson if he has never gone through the process before.

Local and US counsel should work as if they were part of the same law firm—assuming they are not—to provide effective and efficient counsel to the client. It is important for the lawyers counseling the client in such a transaction to be involved in the due diligence process so that issues can be addressed early in the process. If this is not done, it could present difficulties in later negotiations or give rise to a surprise after the closing of the transaction.

For example, when representing a German company that was targeting the purchase of a US company, due diligence uncovered that the average age of the employee base was over sixty and that the health benefits plans were self-insured and under-funded. It was the intent of the German purchaser to reduce the workforce from more than one hundred to twenty-five or less. When we submitted the draft purchase agreement, our draft included provisions to ensure all liability related to the employees and their health care benefits remained with the seller. We advised the German client that these liabilities had to be retained by the seller and it would not be prudent to move forward with the transaction if they were not expressly excluded and indemnified against by the seller. Because of this issue that was uncovered in due diligence, the transaction did not move forward, and the seller simply fired all of its employees and liquidated. Although the German client was disappointed to not acquire the business, and in particular the machinery and equipment, the client avoided millions of dollars in health care liabilities and pension benefits.

Lawyers can support their clients in price negotiations by providing legal arguments concerning the underlying facts of a transaction. However, in most circumstances, price negotiations are handled by management and advising investment bankers. That said, lawyers can provide material assistance on a sell-side by having the purchaser assume certain liabilities that increase value to the seller or on the buy-side by having the seller keep liabilities.

Early in my career, we represented a client that was selling its business and the purchaser through their counsel raised a number of issues during due diligence and the contract negotiations. As counsel to the seller, we were of the opinion that the issues raised were no basis for a price reduction and that the potential contingent liabilities should be assumed in the ordinary course of business. The interesting fact in the transaction is that our client had executed the purchase agreement and transmitted its signature page to the purchaser. The purchaser did not return a duly executed signature page. We advised our client to revoke its offer under the US law-governed agreement. Based on that counsel, the client instructed us to communicate a revocation of offer. That resulted in the purchaser accepting all of the terms our client desired and the transaction ultimately closed, earning the seller close to an additional one million dollars of consideration on a $23 million transaction.

**Anti-Trust Considerations**

Due to the size of transactions being accomplished in recent years, the Federal Trade Commission and the Department of Justice increased the dollar threshold amounts, which subjected many transactions with US parties to review. That said, antitrust authorities are still taking a keen look at transactions and in many cases objecting to the underlying transactions. Just recently, NYSE Euronext dropped its bid to merge with Deutsche Börse AG due to the anti-trust scrutiny it was undergoing. On February 14, 2011, both the Department of Justice and the European Commission cleared Google's bid to acquire Motorola Mobility for $12.5 billion, although regulators in China, Israel, and Taiwan had yet to bless the transaction, which could cause significant issues with the deal. Another transaction concurrently in the news is the prospective merger between The International Paper Co. and Temple-Inland Inc. where US antitrust regulators ordered that the parties would have to divest three containerboard mills before they can move forward with a planned $4.3 billion merger.

Today's international M&A transactions that are subject to antitrust approval generally require special counsel in various jurisdictions to shepherd the transaction through the approval process. The practitioner needs to be cognizant of the timing for approval and build that into the transaction timeline as well as educate the client on the process.

**Conclusion**

A practitioner will want to consider numerous factors when commencing an engagement to represent a client in connection with an international M&A transaction. The representation goes far beyond the mere drafting of a stock purchase agreement or asset purchase agreement, but must involve the nuances of cultural differences, which can be both from a national (i.e., country) or operational (i.e., the actual company) perspective, the latter of which will have a larger impact on the business people managing the transaction. Subsequent to the closing of the transaction, counsel should follow up with the client and local counsel to ensure that all post-closing conditions, if any, have been met and to provide additional assistance in the event such is needed. If given the opportunity, visit the foreign target before and after the transaction to gain additional insight as to the business and provide better counsel during the transaction and post-closing.

**Key Takeaways**

- Gain familiarity with the application of international business-related regulations, such as ITAR, FCPA, Dodd-Frank Act, and the UK Bribery Act.
- Get involved in the due diligence process of the client you are counseling to spot issues that might be problematic early in the process. This will make it possible to address the issues and deal with them, to prevent them from becoming an unpleasant or difficult surprise after the deal closes, and to even stop the process if necessary without penalties being levied.
- Have a good understanding of both the national and organizational culture.
- Make use of relevant foreign language skills, if available. They can be extraordinarily valuable in a negotiation.
- Associate with knowledgeable local counsel.

**Related Resources**

- Mehdi Majidi, *Cultural Factors in International Mergers and Acquisitions: When and Where Culture Matters,* 6 THE INTERNATIONAL JOURNAL OF KNOWLEDGE, CULTURE AND CHANGE MANAGEMENT, No. 7 (2007).
- Daniel Rottig, *Successfully Managing International Mergers and Acquisitions: A Descriptive Framework*, INTERNATIONAL BUSINESS: RESEARCH, TEACHING AND PRACTICE, THE JOURNAL OF THE AIB-SE (2007).
- The Foreign Corrupt Practices Act of 1977 (FCPA), as amended, 15 U.S.C. §§ 78dd-1, *et seq*.
- International Traffic in Arms Regulations, CFR Title 22, Chapter I, Subchapter M (ITAR)
- The UK Bribery Act
- Dodd-Frank Act Section 1502: Supply-chain due diligence
- Dodd-Frank Act Section 1504: Transparency legislation

*Michael E. Zeller has been with Moore & Van Allen, PLLC since 1995 and currently chairs the Global Services Practice Group. He gives his regional, national, and international clients passionate, straightforward counsel in general corporate representation, mergers and acquisitions, franchising, and inbound and outbound international trade. Fluent in German and formerly associated with DROSTE (now Hogan Lovells), a prominent Hamburg, Germany law firm from 1992 to 1994, Mr. Zeller assists foreign clients in establishing business relations or subsidiaries in the United States and advises US-based clients on the development of trading opportunities abroad, joint venture agreements, distributor and agency agreements, sales representative agreements, licensing agreements, and disputes with the US Customs Service.*

*Mr. Zeller serves as Moore & Van Allen's contact partner for the firm's participation in Globalaw (www.globalaw.net), a worldwide network of 106 independent law firms with more than 4,500 lawyers in 160 cities. Mr. Zeller is also a member of the* Gewerblicher Rechtsschutz und Urheberrecht Verband, *the International Franchise Association, the ESOP Association, and the National Center for Employee Ownership, among other organizations. He serves pro bono as an informal hearing officer for the Charlotte Housing Authority and serves as pro bono outside general counsel to Charlotte Mothers of Multiples, Incorporated (www.charlottemultiples.com).*