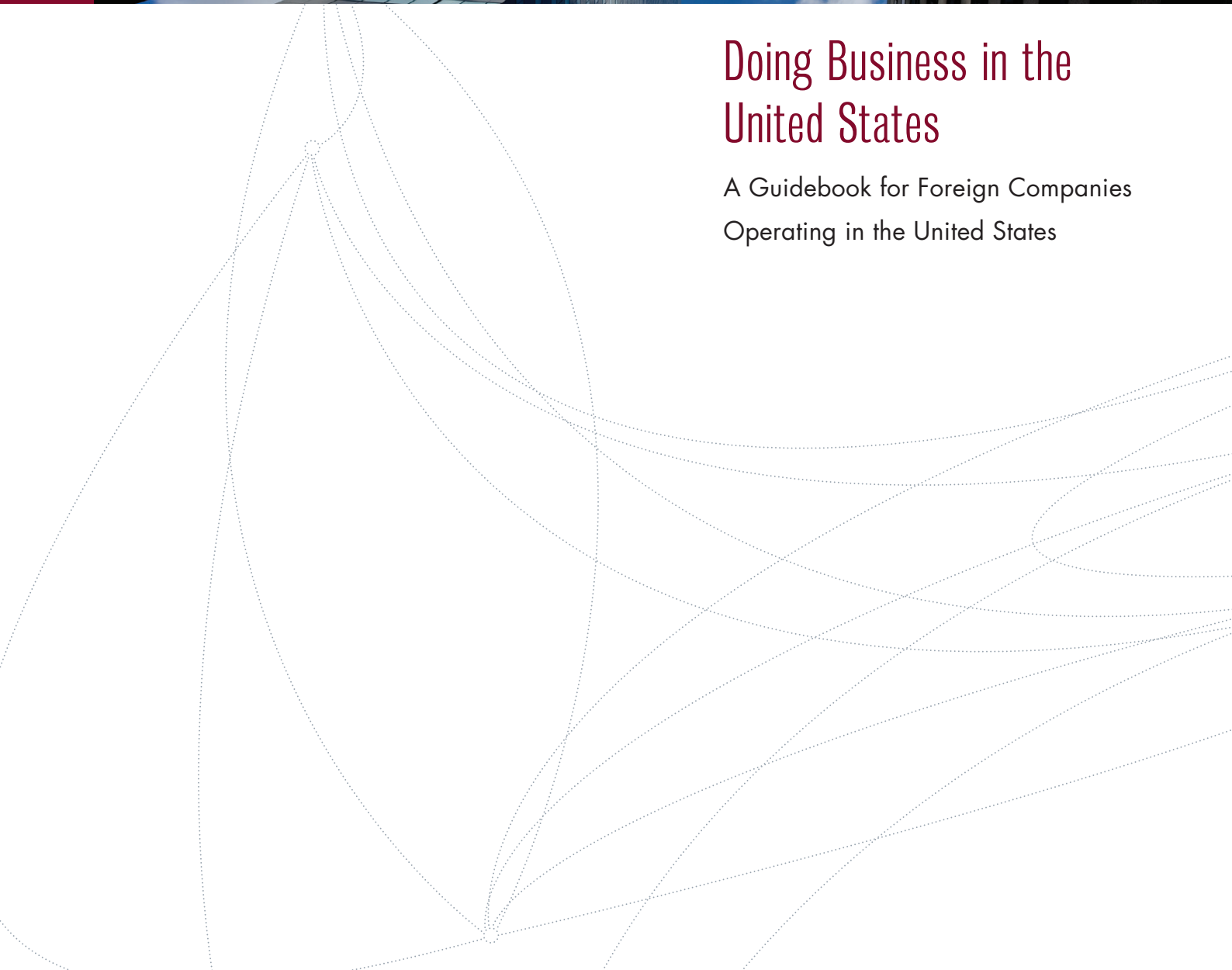




Doing Business in the United States

A Guidebook for Foreign Companies
Operating in the United States



K&L GATES LLP

DOING BUSINESS IN THE UNITED STATES

A GUIDEBOOK FOR FOREIGN COMPANIES OPERATING IN THE UNITED STATES

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This Guidebook is not intended to be, and does not constitute, legal advice with respect to the matters discussed and should not be relied on as such. It is, by its nature, general in scope. An attorney should be consulted regarding the legal implications of any particular facts or circumstances.

Chapter 1

Doing Business in the United States

a. Introduction

Foreign companies operating in the United States encounter numerous legal and regulatory issues. Anticipating and dealing appropriately with those issues can improve markedly the success of those operations. The purposes of this Guidebook are to identify and discuss the legal and regulatory issues commonly faced by foreign companies commencing operations in the United States. It also can serve as a helpful checklist and monitoring device for foreign companies already operating in the United States or considering expansion of those operations. The Guidebook references various Delaware laws and regulations for the purpose of providing examples of certain concepts. The laws and regulations of other states may vary.

This Guidebook is not intended to be, and does not constitute, legal advice with respect to the matters discussed and should not be relied on as such. It is, by its nature, general in scope. An attorney should be consulted regarding the legal implications of any particular facts or circumstances.

b. K&L Gates International Practice

The topics covered in this Guidebook are not exhaustive and undoubtedly will prompt inquiries into other related issues. The attorneys at K&L Gates are experienced in dealing with inbound investments and operations of foreign companies in the United States. K&L Gates provides international clients with advice and counsel on legal issues on a broad array of matters, including the following:

- Formation and Operation of Corporations and Limited Liability Companies
- Patent, Trademark, Copyright and Intellectual Property Protection
- Mergers, Acquisitions and Joint Ventures
- Commercial Transactions
- Electronic Commerce and Internet Law
- Immigration
- Taxation
- Litigation
- Securities Offerings
- Venture Capital
- Employee Benefits
- Employment Law
- Governmental Relations
- Land Use and Zoning
- Real Estate Development and Finance
- Financing Arrangements
- Antitrust
- Estate Planning
- Environmental Law

Please visit our website at www.klgates.com for a more detailed explanation of the services that K&L Gates provides.

Chapter 2

Operations in the United States

a. Business Climate

Americans fully appreciate that they live and work in a global marketplace and that the long term interests of the United States are best served by their active participation in the global economy. An important element of that participation is providing access for foreign companies to United States markets with minimal impediment. While competition in the United States is healthy and spirited, United States businesses and business communities are receptive to foreign companies entering United States markets.

b. Trade Agencies and Organizations

Various federal, state and local governmental agencies, as well as business and trade organizations, facilitate foreign investment and operations in the United States. Inquiries made by foreign companies to these agencies and organizations can yield important information concerning various aspects of doing business in the United States.

The United States Department of Commerce is the primary federal agency involved in that effort. Contact information for the Department's local services and offices is listed on its website at www.commerce.gov/services/index.htm.

State and local governments also have agencies that promote foreign company investment and operations. Those agencies can provide a wealth of knowledge about opportunities in their respective states, and it is well worth checking with them when considering operations in the United States. Information about these agencies is readily available through the Internet.

Various local organizations and trade groups also encourage and facilitate United States operations of foreign companies. Examples of those types of organizations include Chambers of Commerce and various regional partnerships. An Internet search of a region's economic development efforts will yield a trove of useful information.

Because the presence of foreign companies is quite substantial in many communities, trade groups and societies also have evolved over the years. These organizations (i) promote dialogue on international issues, (ii) assist in making foreign company personnel feel at home in the United States and (iii) help foreign companies assimilate into the fabric of the United States business community. Many regions within the United States host local World Affairs Council and World Trade Association chapters.

c. Legal Environment

The following description is quite general in nature but attempts to provide a general framework of the United States legal system. It is important to understand that the United States has a federal system of government under which each of the states has autonomy and the authority to enact laws and regulate commerce, as long as those regulations do not conflict with federal laws or the United States Constitution. Consequently, business operations in the United States must comply with state as well as federal requirements.

Foreign companies (like domestic business entities) are subject to two general sets of legal guidelines. The first is "statutory law," consisting of various statutes, laws and ordinances enacted by elected legislative bodies (the United States Congress, state legislatures, local municipal governments,

etc.). The other is known as “common law,” which is a body of law that has developed from court cases in the United States.

Both statutory law and common law may have a bearing on particular legal issues. As an example, when a business discharges an employee, the business is subject to a number of statutory law restrictions (e.g., anti-discrimination laws), as well as various common law principles (e.g., “intentional infliction of emotional distress”).

(i) *Statutory Law*

There are a number of legislative bodies in the United States that have the authority to enact laws governing commerce in the United States. At the top of the chain is the federal government, which enacts laws in areas permitted by the United States Constitution. Federal statutes are limited by the United States Constitution to matters of broad applicability. In those permitted areas, the federal government is said to “preempt” any conflicting or inconsistent legislation enacted by state or local governments. All other matters are reserved to the legislative bodies of the states.

Regulation of interstate commerce (i.e., commerce that crosses state lines) is an example of an area of permitted federal legislation. It is of paramount importance to the United States economy that goods and services flow freely throughout the United States and that no state or local government deter or interfere with interstate commerce. Consequently, it is within the federal government’s purview to enact statutes assuring that businesses, no matter where they are based, can operate without imposition of state or local legislation that gives unfair advantage to local companies or industries.

States, and the cities, towns and special districts within each state, have the authority to enact laws affecting intrastate commerce (i.e., commerce within the state or applicable jurisdiction). An example of a matter reserved to each state is regulation of the formation and operation of business entities. Corporations, limited liability companies and other business entities are not formed under federal law. Those entities are creatures of state law, with each state having its own set of laws governing the formation and operation of business entities within that state.

(ii) *Agency Rules and Regulations*

In order to fully implement statutory law, legislative bodies have created various governmental agencies that develop administrative rules and regulations for that purpose. An example is the Environmental Protection Agency, which is a federal agency that implements and enforces laws enacted by the United States Congress to protect the environment. Administrative agencies are necessary because it would be impracticable for Congress to provide in a statute all of the many directives necessary to fully carry out a legislative scheme. Instead, Congress delegates to the agencies the task of developing rules and regulations that will properly implement those statutory principles.

Similar to the federal government, each state government has regulatory agencies that interpret and implement laws enacted by that state’s legislature. Those laws are intended to complement or supplement federal statutory laws and may address issues specific to the particular state. Actions of regulatory agencies (federal and state) typically can be challenged administratively, and in court, if they are unconstitutional or inconsistent with the general principles prescribed by the legislative bodies.

(iii) *Common Law*

Statutory laws usually do not deal with standards of normative behavior, or how people should behave under a model standard. Those principles are the province of common law. For example, under the common law principle of “*respondeat superior*,” an employer may be held liable for acts of an employee performed within the scope of employment. As well, if a business improperly interferes with a contractual relationship of another business, the business that is damaged by such “*tortious*” action may recover its damages in a court proceeding, under common law principles.

“Common law” has evolved over the years from legal principles originally established in other common law countries (primarily England), although in many cases with unique American twists. Common law principles develop through court cases in the United States and are articulated by judges in their decisions.

(iv) *Court Systems*

When statutory law or common law principles are violated, recourse ultimately is through litigation. Typically, claims arising under federal laws (and sometimes claims of any nature that involve parties from different states) are enforced in federal courts, with other matters being handled by state courts.

In the federal judicial system, the Supreme Court of the United States is the ultimate arbiter of federal law issues, but the vast majority of federal cases are resolved at lower levels of the federal court system. The entry level court in the federal system is the United States District Court. Appeals from decisions of that court are made to regional United States’ Courts of Appeal, with ultimate appeal to the United States Supreme Court. There are also several specialty courts in the federal system designed to deal with specific types of cases (*e.g.*, the United States Tax Court for federal tax matters and the Federal Circuit Court of Appeals for appeals of certain patent and international trade cases).

State courts are fashioned, in most cases, on the federal model. Lower courts serve as intake courts for most cases, with an appellate court level above the trial court and a state supreme court sitting as the final arbiter of disputes. As an example, depending on the type of action and amount in controversy, initial entry into a state court system is through a lower court (typically housed in each county). Appeals from those courts are to the state’s court of appeals, with final appeals being made to that state’s supreme court. Under some circumstances, decisions of a state supreme court can be appealed through the federal judicial system.

Court cases are generally commenced by filing a “complaint” in the appropriate court. That action is followed by an “answer” by the defendant, which places the controversy at issue before the court. All court systems have policies and procedures enabling parties to obtain information about the subject of the dispute (“discovery”) and for presenting evidence to the court (“rules of evidence”). Court cases typically follow prescribed procedures and may be heard by a judge alone or by a judge and a jury, depending on the circumstances.

d. Cultural Differences

The business environment in the United States likely will differ significantly from that in a foreign company’s home country. Differences range from insignificant items (*e.g.*, dates in the United States typically being written with the month first followed by the day and year, with January 5, 2010 being abbreviated 1/5/10) to those with great import (*e.g.*, the interactions between an employer and employee). A foreign company should make reasonable efforts to try to understand and appreciate those differences when conducting operations in the United States.

The United States is a large and diverse place, with local practices and business methods varying significantly from one area of the country to another. As well, protocols and business practices differ from industry to industry. Cataloging the various cultural norms and variations throughout the United States, and contrasting them with comparable practices in foreign countries, would require several volumes. The following are a very few examples of the types of cultural differences that a foreign company might encounter in establishing operations in the United States.

(i) *Contracts*

In some countries, laws and statutes provide significant background structure and detail for business relationships, so that lengthy contracts covering those items are not absolutely necessary. That is not the case in the United States, where the clear preference is to document business relationships in detailed and precise written agreements.

Business people have a natural aversion to dealing with controversial and unpleasant details in their commercial relationships, but failure to address those issues at the outset can severely impair that relationship. The importance and necessity of well drafted, and thorough, written contracts increase with the significance and monetary value of a contractual arrangement. Even in the most amicable commercial setting, disagreements can arise or be affected by outside influences, making clear contracts essential.

Because the parties are exercising the freedom to contract with few outside limitations while also trying to achieve contractual precision, written agreements in the United States tend to be longer than in many other countries. This approach has worked well in the United States, since it both permits the parties great flexibility in crafting their agreement and forces the parties to address and resolve the more difficult and potentially divisive issues at the beginning of the relationship. The parties then can concentrate on their core businesses, without distraction from serious, unanticipated issues arising later in the relationship.

Despite protestations from a company's trading partners about the length and complexity of proposed contracts, thorough contracts have long been accepted as the norm in the United States. All businesses in the United States are familiar with lengthy contracts. After complaining about the length or detail of a proposed contract, most trading partners quickly proceed to dealing with the particulars and concluding the agreement. Foreign companies setting up operations in the United States should avoid contracts that lack precision and breadth and should insist that commercial relationships of any significance be clearly and completely documented. Caution is in order if a trading partner in a significant business relationship inordinately protests preparation of comprehensive documentation.

In the United States, while statutes and common law provide some guidance for the interpretation of business relationships, the contract is "king." A written agreement between the parties is the best and most accurate reflection of that relationship and is given great weight in assessing the duties and obligations of the parties. United States contracts are expected to provide a blueprint and set boundaries for the entire scope and length of a transaction, and are not viewed as just a starting point for the relationship. Businesses operating without written contracts do so at their peril.

(ii) *Community Involvement*

In the United States, companies take an active role in the communities in which they operate. They become part of the fabric of those communities. Not only does participation improve the community and its citizens, but it also is an important part of the success of the business. It builds goodwill and creates an environment conducive to attracting and retaining quality personnel. Examples of that involvement might include financial or service support for local charitable organizations, providing personnel to tutor students in the public schools or participating in dialogue through international groups. Companies often encourage their employees to participate in civic groups.

(iii) *Arbitration and Litigation*

Dispute resolution procedures in the United States may be unfamiliar to a foreign company. The “prevailing” parties in most types of litigation are not automatically entitled to recover the costs and expenses that they incur in the proceeding. Parties typically pay their own legal fees, although that general rule can be altered by express agreement of the parties in certain contracts. Another difference is the considerable planning that is required when (i) selecting the appropriate court in which to bring a lawsuit, (ii) deciding when to take that initiative and (iii) identifying the appropriate parties to join in the action. These are all fact specific considerations that require the input of a skilled litigation attorney.

Because litigation in the court systems of the United States can be very time consuming and expensive, the trend in the United States has been toward alternative dispute resolution procedures (mediation and arbitration). Those processes are described more fully in Chapter 11, *Supplier and Customer Contracts*. Before full scale litigation is permitted to proceed, many states require that parties participate in mediation efforts, to see if common ground for settlement can be found.

e. *Relocation Incentives*

Some states and local communities in the United States provide incentives for businesses that are relocating to, or significantly enhancing their presence in, those jurisdictions. Consequently, foreign companies should explore those possible incentives, which might take the form of (i) grants for training of local employees, (ii) funding for workforce education programs, (iii) enhancements of roads and transportation facilities, (iv) lower than market interest rates on facility financing (industrial development bonds, attractive land lease arrangements, etc.), (v) local property tax reductions and rebates, (vi) state income tax credits or (vii) in-kind grants of services or products.

Chapter 3

Entity Selection

One of the most important decisions to be made by a foreign company establishing business operations in the United States is what type of business entity in which to operate. That decision is complex, involving factors unique to each circumstance and requiring analysis of the considerations covered generally in this Chapter but supplemented by Chapter 4, *Corporation Formation and Operation*; Chapter 5, *Limited Liability Company Formation and Operation*; Chapter 6, *Taxation of United States Operations* and Chapter 13, *United States Joint Ventures*.

a. Branches and Divisions

If a foreign company operates directly in the United States, it usually does so through an internal “branch” or “division.” A branch or division has no separate legal entity status, in and of itself. It is merely a part of the foreign company. Consequently, there is no intervening entity between the foreign company and third parties dealing with its United States operations. Because of the potential liability exposure and significant tax complexities encountered when operating through a United States branch or division, many foreign companies avoid direct operations in the United States, absent special circumstances (*see* Chapter 6, *Taxation of United States Operations*). If a foreign company does operate in the United States directly, it should try to limit its contractual and product liability exposure and obtain adequate insurance to protect against those potential liabilities.

b. Subsidiary Corporations

By contrast, a United States subsidiary corporation is a separate legal entity, owned (wholly or partially) by the foreign parent company. A subsidiary is distinct from the parent company, because it is separately incorporated in the United States. It has its own internal governance structure and operational independence. Subsidiaries provide a shield for their owners against liability for claims made against the subsidiary, protection not afforded by the branch or division structure. It is very important that the United States subsidiary maintain its independent status, because insulation of the foreign parent company from liability to creditors of the subsidiary is dependent on that status.

Although owned by a foreign company, a United States subsidiary corporation is domiciled (for tax purposes) in the United States and is subject, generally, to the same income tax rules under the Internal Revenue Code as other United States corporations. Consequently, all of the subsidiary’s worldwide income is subject to tax in the United States. However, special rules apply to distributions to the foreign parent company. Those rules and related issues are discussed in Chapter 6, *Taxation of United States Operations*.

c. Partnerships

If a foreign company operates through a general partnership in the United States, the results (for liability and tax purposes) will be comparable to operations through a branch or division. For that reason, use of a general partnership, with the foreign company as a direct general partner, is typically avoided. General partners are responsible, without limit, for any liabilities incurred by the partnership, and they will be subject to tax in the United States on their allocable share of income of the general partnership. The liability exposure of a general partner can be mitigated, to some degree, if the general partner is itself a corporation (or another entity carrying a liability shield) with limited assets. If it is necessary to use a general partnership, it is sometimes advisable to create a single purpose limited liability company or corporation for purposes of owning the general partnership interest. That structure

provides a liability shield between creditors of the general partnership and the ultimate owner (assuming the integrity and effectiveness of that single purpose entity).

Limited partnerships are variants of general partnerships. They provide liability protection for the “limited partners,” but the general partners remain liable, generally, without limit. Taxation of the limited partners is comparable to that of partners in a general partnership. Because all owners (members) of a limited liability company are shielded, generally, from liability for actions of the limited liability company, the use of limited liability companies has increased dramatically, relative to the use of limited partnerships. However, limited partnerships still remain a possible alternative in special circumstances.

General partnerships are governed, to a degree, by statutes in the state where the partnership is formed, but substantially all of the particulars of general partnership operations are covered by a partnership agreement between the partners. Except in the case of limited partnerships, no state filing or reporting (as to the structure or operation of the enterprise) is usually required, although there are income tax reporting and withholding requirements, as is the case with other business entities.

d. Limited Liability Companies

While corporations always have been a central part of the United States business landscape, limited liability companies are a more recent entrant, having evolved during the past decade. Both corporations and limited liability companies are creatures of state law. Each state has its own statutes authorizing formation and organization of those entities.

As described in Chapter 6, *Taxation of United States Operations*, both general partnerships and limited liability companies are taxed in the United States under the partnership taxation scheme. Income from the operations of those entities “flows through” to the owners of the business (the “partners” of a general partnership and the “members” of a limited liability company). Those owners file tax returns and report and pay tax on that income.

While limited liability companies and partnerships are taxed in the same way, the liability of their respective owners for debts and obligations of the business differ significantly. As noted above, general partners in a general partnership are liable, without limit, for activities of the general partnership. On the other hand, limited liability companies provide the same liability protection for their owners (members) as do corporations for their stockholders.

One of the drawbacks to limited liability companies is that they are not eligible to participate in tax-free reorganizations in the United States, because the reorganization provisions of the Internal Revenue Code apply only to entities taxed as corporations. Consequently, the ability to dispose of an interest in a limited liability company through a tax-free exchange for stock of a publicly-traded company may be limited.

e. Securities Laws

As discussed in more detail in Chapter 7, *Regulation of Foreign Companies*, stock and certain interests in limited liability companies and limited partnerships are “securities.” The offer and sale of securities is governed by various restrictions and registration requirements imposed by federal and state law, which are intended to safeguard the investing public. To the extent that an ownership interest constitutes a security, it should only be issued pursuant to an exemption from the registration requirements or, in the absence of an exemption, pursuant to a registration statement filed with applicable regulatory agencies.

Chapter 4

Corporation Formation and Operation

a. Formation and Entity Status

Each state in the United States has its own statutes authorizing the formation of business entities, such as corporations and limited liability companies. A business entity formed pursuant to a state's statutes is subject to that state's laws, as well as to applicable federal laws and the laws of other states where that entity does business. This Chapter discusses the formation and operation of corporations. The following Chapter deals with limited liability companies, although, as noted in both Chapters, some of the concepts addressed in this Chapter are equally applicable to limited liability companies. For a visual layout of the process for the formations of a corporation and a limited liability company, attached to the end of this Guidebook as Attachment 3 is a flow chart indicating the steps in such process.

Deciding in which state to form an entity requires some analysis and consideration. Fortunately, most states with significant business communities have modern statutes that promote easy formation and operation of business entities. The decision in many cases hinges on issues such as (i) the physical location of the principal offices in the United States, (ii) where in the United States business will be conducted, (iii) tax considerations and (iv) other business driven considerations.

(i) Corporate Name

The name of a corporation must conform to the requirements of the state statute under which the corporation is formed. Those statutes generally accommodate use of almost any name for a business, as long as the name (i) clearly denotes the type of business entity that has been formed (*i.e.*, corporation, limited liability company, etc.) and (ii) is not the same as, or deceptively similar to, another business entity formed or qualified to do business in that state. Typical of most states, statutes in Delaware require that the name of a corporation formed in those states contain words such as "corporation," "incorporated," "limited" or abbreviations of those words.

It is important to note that, while a state may permit filings under a certain name (because no other identical name is then on file in that state), a corporation may not necessarily have the right to use that name in commerce to the exclusion of others. There may be a deceptively similar name already of record in that state (or in another state) that may have preexisting rights superior to the new corporation.

Also, other persons may have made name protection filings with the Federal Patent and Trademark Office that may significantly limit or eliminate any rights that the new corporation may have with respect to its name or any confusingly similar name (*see* Chapter 15, *Protection of Intellectual Property*). Again, the fact that a state permits a filing of a particular name does not, by itself, create irrefutable rights in that name. Those rights are determined under state and federal law governing trade name usage.

For these reasons, at the outset of a new business operation in the United States, it is important that the proposed name (as well as proposed trade names, identifiable slogans and marks) be evaluated to assure that their use can be protected, with a reasonable degree of certainty, and will be free of interference from those claiming prior superior rights.

Foreign companies and their United States subsidiaries, in their own right, should take advantage of the protections afforded other businesses in the United States by making federal and state filings to protect their distinctive names, logos and slogans. Those filings can be quite important in preventing

other businesses from pirating, or infringing on, those valuable assets. *See* Chapter 15, *Protection of Intellectual Property*, for additional information about that process.

(ii) *State Formation Filings*

In most states, in order to form a corporation, Articles of Incorporation (or a comparable document, such as a “Certificate of Incorporation” in Delaware) must be filed with the appropriate state agency (usually the Secretary of State). For instance, in order to form a Delaware corporation, a Certificate of Incorporation must be filed with the Office of the Secretary of State of Delaware. The Certificate of Incorporation is accessible to the public.

Statutory business entities such as corporations and limited liability companies do not come into existence until the formation documents (*e.g.*, the Articles of Incorporation in the case of a corporation) are filed with the appropriate governmental agency of the state of formation. Consequently, if a corporation or limited liability company will be the vehicle through which a foreign company will do business in the United States, it is important that state filings be completed as soon as practicable once the decision to operate in the United States has been made. The foreign parent company should avoid significant preliminary activity in the United States in its own name, if it desires to avoid direct liability for those actions and the possible creation of a permanent establishment for United States taxation purposes (*see* Chapter 6, *Taxation of United States Operations*).

Articles of Incorporation require basic information about the entity, including the following:

- name of the corporation
- the number of shares of stock that the corporation is authorized to issue
- the name of the registered agent and address of the registered office of the corporation
- the name and address of the incorporator

The Articles of Incorporation may include additional provisions that are deemed advisable or are required in the particular circumstances. For instance, many corporations provide in their Articles that members of the Board of Directors shall have no personal liability for actions taken by them in that capacity, and many state laws require that certain provisions be expressly set forth in the Articles. Similarly, if the corporation is to have separate classes of stock, or if special voting rights will be applicable to holders of certain stock, those provisions should be set forth in the Articles.

Most state statutes do not require that the purpose of the entity be included in the Articles of Incorporation. If the purposes are not set forth, it is presumed that the corporation is authorized to conduct any type of business permitted for a corporation. The owners of the entity (limited liability companies, as well) may want to restrict the purposes of the entity in the Articles, in order to confine the scope of the entity’s operation and to put the public on notice (through the Articles) that activities of the entity are limited.

It is permissible (but not required in most cases) for the names of the initial members of the Board of Directors to appear in the Articles of Incorporation, and for privacy purposes, the names of directors typically are not set forth in the Articles of Incorporation. Directors are named in the organizational documents for the entity (discussed below), which are not filed with the state and generally are not available to the public. However, some states require that annual reports be filed with the Secretary of State, which list the current officers and directors. Those filings typically are available to the public.

While most filings are made with the office of the Secretary of State of the particular state, filings also may be required with the Department of Revenue of the state. Further, various filings also may be

required with the local governments where the business will operate (city, county, etc.). If the business entity will be using a trade name that differs from its legal name, as reflected in the Articles of Incorporation, a “Certificate of Assumed Name” (or comparable document) may need to be filed in the local Register of Deeds or with the Secretary of State. This puts the public on notice that the business entity is operating under a trade name that is different from the name in the Articles of Incorporation.

(iii) *Registered Agent and Office*

As noted above, the Articles of Incorporation that are filed with a state require the designation of a registered agent and registered office in that state. The purpose of this requirement is to provide the public and regulatory agencies with a name and address where notices and other formal communications to the corporation can be directed (*i.e.*, tax notices, court documents, summonses, etc.).

The registered agent must reside in the applicable state and have a street address there (post office boxes will not suffice). Since important documents may be delivered to the registered agent (some requiring responses within specified periods of time), it is important to designate a responsible person as the registered agent. Attorneys and accountants typically do not serve in that capacity, so if a foreign company forming a new business entity in the United States does not have a responsible person residing in the state of formation, it likely will want to name as its registered agent one of the commercial enterprises that provide that service for a fee. Those fees are usually quite reasonable, and the services usually include helpful literature on how to comply with the various filing requirements in the applicable state.

(iv) *Importance of Maintaining Entity Status*

One of the most important benefits of operating a business through a business entity such as a corporation or a limited liability company is that the owners of the entity (the stockholders or members, as the case may be) are not liable, generally, for debts and other obligations that arise in the operation of the entity. That protection is only afforded if the entity is operated as a separate enterprise, independent from the owners and their other activities.

In order to preserve and maintain that separate entity status, the United States business entity should have its own books and records, financial statements, minute books, bank accounts, stationery, business cards, invoices, order forms, etc. It must be clear that the public is dealing with that particular United States business entity and not with its owners. Of course, the United States business entity can have commercial dealings with its foreign parent company, but those relationships should be documented and conducted in the same way as would be done with an unaffiliated third party.

The United States business entity should have separate and distinct governing bodies (*e.g.*, Board of Directors, officers, etc.). It is advisable (but not required) that the Board of Directors and officers not mirror precisely the composition of comparable governing bodies of affiliated companies.

While, as a general matter, the financial exposure of owners of a United States business entity will be limited to the investment made by those owners in that entity, additional exposure may be incurred if the owner voluntarily consents to that exposure. For instance, a supplier or landlord of a business may refuse to deal with the United States business entity without a guaranty from the owner. Such guaranties, if enforced directly against the owners, may result in liabilities significantly greater than the amount invested in the United States business entity. Guaranties should be carefully considered and documented. Provisions that can be negotiated into guaranties to limit the exposure include (i) requirements that the creditor first exhaust all remedies available against the United States business entity before calling on the guarantor and (ii) “burn off” clauses, terminating the guaranty when the net worth of the United States business entity reaches a certain level, a certain time period has passed, etc.

Insurance can also be an effective means of safeguarding the value of a foreign parent company's investment. The United States business entity should carry appropriate levels of comprehensive business liability insurance, directors' and officers' insurance, errors and omissions insurance and other insurance products tailored to the particular needs of the company.

b. Organization

Once the Articles of Incorporation have been filed with the Secretary of State, the corporation is in existence and ready to be organized. Since the incorporator typically is the only person that is of record with respect to the formation of the corporation, the incorporator must take the first step in organizing the corporation.

(i) Initial Action of Incorporator and Board of Directors

The incorporator initiates the organization process by signing a short written consent adopting the Bylaws of the Corporation and appointing the initial Board of Directors. Members of the Board of Directors need not be stockholders or officers of the corporation or residents of the state of incorporation or of the United States. Foreign nationals can be named as directors and officers. Unlike in some countries, labor representatives need not be appointed to the Board of Directors.

In some cases, the incorporator is the attorney for the principals or is one of the principals behind the new enterprise. The incorporator (in that capacity) acts as agent for those principals when initiating the organization of the corporation but ceases to be an official part of the entity upon signing the initial organizational consent.

Once the incorporator has appointed the initial Board of Directors, that Board then completes the organization of the corporation. The Board of Directors typically takes action in one of two ways. It can call an actual meeting of the Board of Directors, or alternatively, action can be taken by written consent of the Board of Directors, without a meeting, if done in compliance with applicable state statutes.

The initial actions of the Board of Directors typically include the following:

- ratifying and confirming the actions of the incorporator
- confirming the Bylaws adopted by the incorporator
- electing officers of the corporation
- approving the initial issuance of stock to the subscribers
- authorizing the opening of bank and brokerage accounts
- authorizing significant contracts (leases, bank loans, employment agreements, major contracts, etc.)
- any other matters that require authorization or approval of the Board

(ii) Issuance of Stock

Pursuant to authorization from the Board, stock of the corporation is issued to each of the subscribing stockholders upon receipt of the consideration recited in a subscription agreement. It is important that the consideration (cash, property, etc.) actually be transferred to the United States entity so that the stock issuance can be properly effected. While certificates can be accounted for electronically in many states, customary practice is to issue paper certificates signed by the President and Secretary of the Corporation. Those certificates should be kept in a safe place, as they represent the ownership interests in the corporation. Lost certificates can be replaced by the corporation, provided that the stockholder signs

an affidavit indemnifying the corporation from any claims that may arise from a subsequent holder of the lost certificate.

(iii) *Debt vs. Equity*

One of the initial considerations for the owners of a United States business entity is how to capitalize the entity. The two alternatives are equity and debt. In the case of a corporation, the stock subscription letter will recite the amount to be paid for the initial issuance of stock. That amount will be equity capital, as will any additional paid-in capital designated as such by the stockholders.

If additional funding is required, those amounts can be provided either by additional contributions of equity capital (which may or may not require issuance of additional stock) or through loans. Loans can be obtained from third parties or from the owners. Loans from the owners must be on commercially reasonable terms and be properly documented in order to be recognized as loans and not as additional equity capital.

As discussed in Chapter 6, *Taxation of United States Operations*, there may be advantages to injecting funds through loans rather than as equity capital. However, those benefits may be illusory if the United States business entity has insufficient corresponding equity capital. If an entity is “thinly capitalized,” not only might the loan arrangements be reclassified as equity (thereby requiring recomputation of accounting and tax treatment), but it may be a factor in determining whether the entity has independent legal significance, which is important, as discussed above in Paragraph (a) (iv) of this Chapter. Note, however, that unlike many other countries, the United States does not have extensive rules applicable to capitalization and “thin capitalization.”

If loans from the foreign parent company are properly structured, the interest payments on the indebtedness will be deductible for federal and state income tax purposes. The foreign parent company also may receive more favorable treatment on those interest payments than it might on dividend distributions, from the standpoint of United States withholding tax (discussed in Chapter 6, *Taxation of United States Operations*). Advances may not be respected as loans, however, unless those advances are clearly documented and contain customary loan terms and provisions. Loan transactions are critical events for a company and should be memorialized by precisely drafted written documents.

The relative tax reporting positions of the foreign parent company and its United States subsidiary will also be important in determining (i) whether the overall debt structure of affiliated companies would be better served by the United States subsidiary borrowing directly from an independent third party, such as a bank, or (ii) whether it is more advantageous for the foreign parent company to borrow funds and loan those monies to the United States subsidiary. Currency risks will also be a factor in this determination.

State taxation can also play a role in structuring optimal capitalization. For this and the other considerations mentioned above, appropriate capitalization of a United States business entity should be discussed with professional advisors.

c. *Stockholders, Directors and Officers*

The stockholders of a corporation exercise ultimate control over the corporation by determining the members of the Board of Directors. The Board of Directors, in turn, oversees the operations of the corporation and sets policies and procedures, pursuant to which the officers of the corporation conduct the corporation’s business.

Unless the governance documents of the corporation provide otherwise, action by stockholders or the Board of Directors generally can be taken by an affirmative vote of a majority of the stockholders or members of the Board (as applicable) present at a meeting at which a quorum exists. A quorum typically

requires the presence, at a properly called meeting, of more than half of the stockholders or members of the Board (as applicable). Stockholder and Board of Director action can also be taken by written consent (without a formally called meeting) if done in compliance with applicable law and the governing documents of the corporation. Unlike many other jurisdictions, in the United States, a director cannot provide another person his or her proxy or have an “alternate” at Board of Directors meetings.

Officers carry out the day-to-day business of the corporation and serve for terms, and on such other conditions, as are determined by the Board of Directors. Officers typically consist of a President, a Treasurer and a Secretary. Other positions and titles are also used as circumstances require (e.g., Chief Executive Officer, Chief Operating Officer, Vice Presidents, Assistant Secretaries, etc.).

Third parties dealing with a corporation usually will require that an authorized officer of the corporation (with the apparent authority to do so) sign contracts or other documents binding the corporation. For instance, on major contracts like leases and corporate acquisition documents, the President or a Senior Vice President typically should sign. While non-officer managers with delegated operating authority can sign routine day-to-day documents such as small purchase orders and invoices, it is good practice for an officer to sign commitments of any significance. Similarly, the corporation should insist on signatures from authorized officers of its customers and suppliers for large orders, in order to preclude the customer or supplier contesting later the validity of the order.

Stockholders, directors and officers need not be residents of the state of incorporation or of the United States. Foreign nationals residing outside of the United States can fill those positions. It usually is helpful, however, to have an individual with delegated authority physically present in the United States for purposes of facilitating transactions that occur in the ordinary course of business. Further, foreign nationals holding those positions should make sure that their activities in those capacities do not violate United States immigration laws or unintentionally subject them to United States taxation (*see* Chapter 10, *Immigration Law*).

d. Bylaws and Governance Documents

The Bylaws of a corporation set forth the fundamental organizational structure of the corporation. They prescribe methods for calling both stockholders and Board of Directors meetings, as well as the methodology for casting votes at those meetings and the requisite votes necessary to take particular actions. The Bylaws typically cover, among other things, the following items:

- how many stockholders or directors are required in order to constitute a quorum for the conduct of business at a meeting
- authorization of action without a meeting (by written consent) if the appropriate number of signatures are obtained
- number, term and qualification of directors
- authorization of various committees
- manner for giving notice of meetings
- participation at Board meetings by conference telephone
- titles of the various officers of the corporation and details as to their specific roles
- process for appointing and removing officers
- authorizations and restrictions on entering into contracts and loans
- format for issuance, transfer and replacement of stock certificates
- records and financial statements required to be maintained

- provisions indemnifying officers and directors for expenses and other liability incurred in carrying out their duties, if appropriate

In addition to the Bylaws, it is sometimes advisable for the stockholders to enter into an agreement governing their rights as stockholders. Such an agreement is not necessary when a corporation is owned solely by one entity or individual, but if stock is issued to several stockholders, the majority stockholder may wish to have the other stockholders (the “minority stockholders”) execute an agreement imposing certain ownership restrictions and addressing one or more of the following issues:

- requiring that the minority stockholders offer stock back to the corporation or to the other owners first, before offering that stock for sale to any third party (a “right of first offer”)
- requiring the minority stockholders who receive a third party offer to first offer to sell their stock to the corporation or the majority stockholder at the same price (a “right of first refusal”)
- preventing the minority stockholders from making gifts of stock without the consent of the majority stockholder
- obligating the minority stockholders to sell (or giving the corporation the option to purchase) their stock upon termination of their employment, death or other triggering event
- determining the price to be paid for stock purchased on specified triggering events
- restricting voting rights or imposing other restrictions applicable to the minority stockholders, as warranted

e. Taxpayer Identification Number

Each corporation formed and organized under state law in the United States must obtain a federal taxpayer identification number. That number is obtained by filling out, and submitting to the Internal Revenue Service, Form SS-4, which elicits some basic information about the corporation (name of the corporation, principal business location, type of entity, general type of business, etc.). The taxpayer identification number will be used for filing federal tax returns, for other reporting requirements of federal governmental agencies and for filing state tax returns. In some circumstances, states require that an additional identification number be obtained from the state for sales tax and employment tax reporting purposes. Those various identification numbers remain in effect throughout the corporation’s existence.

Chapter 5

Limited Liability Company Formation and Operation

a. Formation and Entity Status

As is the case with corporations, each state in the United States has its own statutes authorizing the formation (and providing liability insulation for the owners) of limited liability companies. Considerations with respect to the appropriate state in which to form a business entity, name usage, the importance of maintaining entity status and the other generic principles referenced in Chapter 4, ***Corporation Formation and Operation*** are equally applicable in the context of formation and operation of limited liability companies. From that point, however, the analysis of limited liability companies and corporations begins to diverge, due to the fact that one of the significant benefits of limited liability companies, relative to corporations, is the great flexibility they offer in structure and operation. Tax considerations are also significantly different from those of corporations.

Statutory law plays a more prominent role in the governance and operation of corporations than is the case with limited liability companies. While there are many rights that automatically vest in stockholders of a corporation under state laws, typically, there are few statutory counterparts in the limited liability company context. State laws give great latitude to the owners ("members") with respect to the economic and governance arrangements of a limited liability company. Those arrangements are to be set out in a document, negotiated by the members, known as an "Operating Agreement."

The balance of this Chapter discusses the mechanics of forming and operating a limited liability company. A flow chart of this limited liability company formation process is attached to the end of this Guidebook as Attachment 3.

(i) Entity Name

As is the case with corporations, it must be clear exactly with what type of business entity the public is dealing. For instance, Delaware law requires that a limited liability company have in its name one of the following designations:

Limited Liability Company
L.L.C.
LLC

Limited liability company name usage, and rights to use a name, are subject to the same considerations as are discussed in detail with respect to corporate names in Chapter 4, ***Corporation Formation and Operation***.

(ii) State Formation Filings

Limited liability companies are formed by filing a formation document with the appropriate Secretary of State. In many states, that document is entitled "Articles of Organization," while in Delaware, "Certificate of Formation." The formation document (hereafter, "Articles") typically contains the following information:

- the name of the limited liability company
- if the existence of the limited liability company is not to be perpetual, the date on which it is to dissolve

- the name and address of the person signing the Articles and whether that person is acting as the organizer (comparable to the incorporator in the case of a corporation) or as a member (an owner of the limited liability company)
- the name and address of the registered agent and registered office for the limited liability company
- if the members are not to be the managers of the limited liability company, a statement to that effect
- any other provision appropriate for the particular limited liability company

“Managers” of a limited liability company are the persons who set policy and conduct the day to day affairs of the company, all within the parameters set out in the Operating Agreement. The members of a limited liability company are presumed by statute to be the managers of the company, unless the members (i) delegate that function to others (in the Operating Agreement) or (ii) vest that function in managers (by including a provision to that effect in the Articles). The latter approach creates what is called a “manager managed” limited liability company and puts the public on notice that the members, as a general matter, may not contract on behalf of the limited liability company and that operational matters require the involvement of the managers.

The managers (whether provided for in the Articles or in the Operating Agreement) need not be members, and as noted above, members need not be managers. Managers are required to discharge their duties prudently, in good faith and in the best interests of the limited liability company. Managers may delegate their authority and duties to others and may appoint officers with titles similar to those used in the corporate context (*i.e.*, President, Treasurer, Chief Operating Officer, etc.), if that helps to clarify their role for third parties. Foreign nationals, whether or not residents of the United States, can hold positions as members, managers or both, although holding an ownership interest in a limited liability company will subject the foreign national to United States income taxation.

(iii) *Registered Agent and Office*

As is the case with a corporation, the registered agent of a limited liability company must reside in the state in which the limited liability company is formed. The primary duty of the registered agent is to receive, on behalf of the limited liability company, any notices, judicial process or demands directed to the company.

(iv) *Importance of Maintaining Entity Status*

Limited liability companies provide the same liability protection to their members as corporations do for their stockholders. Consequently, it is very important that the entity status of the limited liability company be maintained. In that regard, limited liability companies should follow the same precautions as are set for corporations in Paragraph (a)(iv) of Chapter 4, ***Corporation Formation and Operation***.

b. *Members and Managers*

A member of a limited liability company becomes such either by being named as a member in the Articles or by being admitted as a member through the Operating Agreement. Additional members may be admitted, from time to time, following the initial organization in accordance with procedures set forth in the Operating Agreement. Members can be individuals or other business entities and, as noted above, need not be residents or citizens of the United States. A limited liability company can have as few as one member (a “single member LLC”) or as many as desired, subject to the securities law restrictions referenced in Chapter 7, ***Regulation of Foreign Companies***.

The members are the owners of the equity interests in the limited liability company, and the rights, duties and obligations of that status are set forth in an Operating Agreement (including the voting rights of various members). Certificates or other evidence of ownership typically are not issued by limited liability companies, unlike corporations that issue shares of stock. The economic rights of the members are represented by the Operating Agreement.

c. Operating Agreement

The members of a limited liability company have great latitude in designing their rights and obligations, as well as the mechanics of governance and operation of the limited liability company. Those matters are reduced to writing and contained in the Operating Agreement. In some respects, the Operating Agreement of a limited liability company takes the place of all of the governance and operational documents of a corporation (*i.e.*, corporate Bylaws, stockholders agreements, etc.) and many matters governed by state corporation laws.

Limited liability companies are creatures of contract, and while state statutes provide some default rights for members and managers, it is assumed that a detailed Operating Agreement, agreed to by the members, will be the primary instrument determining the members' respective rights and obligations. Consequently, it is quite important that the Operating Agreement thoroughly, completely and accurately reflect the intentions of the members.

The following are provisions typically found in an Operating Agreement:

(i) Initial and Additional Capital Contributions

Operating Agreements contain a schedule listing the capital contributions that each member has made, or will make, to the limited liability company. Those contributions can be in cash or in the form of tangible or intangible property, as agreed by the members. The limited liability company maintains a "capital account" for each member, which is credited with the value of those contributions. It is important that the members determine the likely future capital requirements of the business and obtain commitments from the members to fund those requirements.

The provision of the Operating Agreement dealing with capital contributions typically outlines the procedure for additional capital calls from the members, as well as the consequences of a member failing to comply with a capital call. Capital calls can be made in any number of ways, including by a majority vote of the members, by the managers or pursuant to a schedule of capital commitments. As is the case with most aspects of limited liability company operations, the members are free to design any procedures that fit their needs.

Failure to comply with a capital call can be dealt with in a number of ways. The equity interest of the non-contributing member might be diluted in favor of the contributing members. An alternative would be to treat any excess contributions made by the contributing members (to cover the shortfall) as loans to the limited liability company, to be repaid promptly and with a premium rate of interest. Another alternative would be to treat those excess contributions as loans to the defaulting member, to be repaid by that defaulting member to the contributing members.

(ii) Management

Whether management of the limited liability company is carried out by the members or by appointed managers, actions typically are authorized by a majority vote of the appropriate group. Of course, circumstances may require variations, and the Operating Agreement can specify any process desired by the members. For instance, certain actions may be so fundamental to the relationship of the parties that a unanimous or supermajority vote of the members might be required. Actions that might fall into that category include admission of new members, subjecting the members to personal liability,

incurring significant debt, selling substantially all of the entity's assets and other similarly significant matters.

In order to facilitate the smooth operation of the limited liability company, the Operating Agreement can authorize the members or managers to act in routine matters, without the necessity for a meeting or vote. For instance, the managers may be authorized to enter into contracts that do not exceed, in the aggregate, a predetermined amount.

(iii) *Allocation of Profits and Losses*

Net profit or loss generated by the limited liability company is "allocated" to the members in the manner set forth in the Operating Agreement. The term "allocation" in this context refers to the process of determining which members will report that net income or loss on their tax returns. "Distributions" (described below) refer to the transfer of cash from the limited liability company to its members, which may not and need not track allocations, depending on the agreement of the members.

Net profit and loss allocations do not need to be proportionate with the capital contributed by each of the members or to the voting rights of the members. They can be made in any manner that has economic consequence to the parties and is not just a scheme for shifting tax liabilities between members, with no business purpose. This flexibility distinguishes limited liability companies from corporations, which generally require sharing of net profits and losses by stockholders (in their capacities as such) on a pro rata basis, in accordance with the number of shares of stock held.

As set forth in Chapter 6, *Taxation of United States Operations*, a limited liability company reports to federal and state taxing authorities the members' respective net profit or loss allocation. The members then include that allocation on their own individual income tax returns. The limited liability company itself pays no United States federal income tax (although a few states impose income taxes on limited liability companies in a fashion comparable to corporations).

(iv) *Distributions*

The flexibility of limited liability companies permits the members to agree, as well, on how distributions of cash and property are to be made. Again, "distributions" need not be made in the same manner as net profit and loss "allocations" are made, and need not be based on capital account balances or voting rights. Consequently, arrangements can be made to distribute funds first to those members that have contributed cash or other valuable assets to the limited liability company (as opposed to those contributing just services) in order for those "money members" to receive back their initial investments, before subsequent available cash is shared among all of the members.

Operating Agreements also can provide for distributions of cash sufficient for the members to pay the taxes on profits that are allocated to them and require that any distributions of in-kind property be pro rata, so that no member is disadvantaged by valuation irregularities that may be involved in such distributions.

(v) *Buy/Sell Provisions*

As is the case with corporations, the members holding a majority interest in a limited liability company may want to impose restrictions on members holding minority interests (or who have received their interests for services). A typical provision would impose on those members an obligation to offer first to sell their interests back to the company or to the majority members, before offering the interests to others, and to require that their interests be sold in that manner upon termination of employment or other comparable event. These same issues arise in the corporate context and are discussed in Chapter 4, *Corporation Formation and Operation*.

d. Taxpayer Identification Number

Each limited liability company (other than a single member LLC) is required to obtain from the Internal Revenue Service a taxpayer identification number. Since the limited liability company is typically not a taxpayer itself (passing through all items of income and loss to its members), it nonetheless is required to file tax returns showing the net income and loss generated by the enterprise and how that net income and loss has been allocated to the members.

Chapter 6

Taxation of United States Operations

a. Introduction

Rather than stray into the thicket of particulars surrounding United States taxation of business operations of foreign companies, this Chapter discusses the general framework and principles underlying that taxation scheme.

The United States tax system is designed to permit the country with the closest relationship to a revenue-generating activity of a business to tax that activity preferentially. The system also seeks to minimize the possibility of taxation by multiple countries of a single income stream. Those policies and concerns are addressed through various tax treaty provisions, domestic tax credit mechanisms and related techniques implemented by the United States and its trading partners. In the United States, tax laws are enforced at the federal level by the Internal Revenue Service.

While there are many exceptions, the United States taxation scheme is intended to be economically neutral (so as to not favor one type of company over another) and to create a “level playing field,” where all participants are subject to the same general taxation burden. This enhances competition and strengthens the United States economy. As you will see from the discussion below, however, achieving that laudable goal requires significant complexity.

Inherently, tax planning is based on the facts and circumstances of each situation. Accordingly, any foreign company doing business in the United States should discuss with professional tax advisors, early in the planning process, the most tax efficient structure for United States operations. Further, even if carefully designed for United States purposes, that structure will be less than optimal if it is not coordinated with tax planning in the foreign company’s home country.

b. Effect of Tax Treaties

When evaluating United States taxation of a foreign company’s operations, reference always should be made to the tax treaty, if any, to which the United States and the home country of the foreign company are parties. If the home country has no tax treaty with the United States, the general rules of taxation of foreign companies contained in the Internal Revenue Code will apply. On the other hand, if the foreign company is domiciled in a country that has a tax treaty with the United States, the provisions of the tax treaty, in many cases, will override the general rules of the Internal Revenue Code and may make substantial modifications to the way United States source income is taxed. Treaties also have an impact on the taxation of distributions of net profits from United States operations to the foreign company owner (“repatriated income”).

The Internal Revenue Service is well aware that certain treaties with the United States are more favorable than others. Consequently, the United States has instituted various “treaty shopping” restrictions to discourage elaborate arrangements that direct income through countries with the most favorable treaties (even though those countries have little or no direct involvement with the transaction). Such schemes defeat the general fairness of the treaty system.

c. *United States Subsidiary Operations*

(i) *Taxation of Corporate Subsidiaries*

In many situations, foreign companies find that it is less complicated and more cost efficient (and presents less liability exposure) to operate in the United States through a subsidiary corporation, rather than directly through a branch or division (*see* Chapter 3, *Entity Selection*). In keeping with general rules applicable to all corporations formed in the United States, the subsidiary's income, no matter where earned (inside or outside of the United States), generally will fall within the United States taxing jurisdiction as a result of the subsidiary being domiciled in the United States. Repatriation of earnings of the subsidiary to the foreign parent company, as well, will be subject to United States withholding tax rules, as discussed below.

Corporate subsidiaries of foreign companies are taxed under Subchapter C of the Internal Revenue Code and consequently are referred to as "C corporations." Certain corporations with limited numbers and types of stockholders (*e.g.*, non-resident and corporate stockholders are not permitted) are taxed under the provisions of Subchapter S and are known as "S corporations." Because of those restrictions, corporate subsidiaries of foreign companies are not eligible for S corporation classification.

United States income taxation of those subsidiaries is based on the corporate income tax rate (then in effect) multiplied by the taxable income of the subsidiary for the subject taxable year. Taxable income is computed by subtracting all deductible expenses from the gross income of the subsidiary. Tax returns are to be filed within two and one-half months following the end of each taxable year, with estimated taxes generally paid quarterly and with any remaining unpaid taxes being due at the time the return is filed. Comparable state taxes are discussed briefly below.

In addition, all employers in the United States pay federal employment taxes, which are usually remitted monthly and are based on a percentage of the employer's payroll. Employers are also required to withhold, from their employee paychecks, the federal and state income taxes that their employees are expected to owe with respect to those wages. The employer remits those withheld amounts to the Internal Revenue Service and the states on behalf of the employees.

The laws and regulations governing the above-referenced matters fill many volumes and cannot be given justice in this Chapter. Fortunately, there are many knowledgeable and experienced tax professionals in the United States that can assist foreign companies in navigating these waters.

(ii) *Transfers of Appreciated Assets*

A foreign company must plan carefully if it intends to transfer appreciated assets to its United States subsidiary. When properly structured, those transfers can be accomplished without immediate tax consequence. However, there may be implications for the foreign company in its home country with respect to such a transfer. It is also possible that all appreciation in the assets (including appreciation that occurred prior to the transfer to the United States subsidiary) may be taxed in the United States if those assets are subsequently disposed of by the subsidiary. That can be the case, as well, when assets are transferred to a branch or division of the foreign company in the United States.

(iii) *Taxation of Dividend and Interest Payments to Foreign Parent*

As a general matter, dividend and interest payments by a United States subsidiary to a foreign parent are subject to withholding (*i.e.*, a flat rate of tax) in the United States. The general rule is that 30% of dividend and interest payments are to be withheld by the United States subsidiary and remitted to the Internal Revenue Service.

Those rates typically are reduced if the parent company is domiciled in a country that is a treaty partner with the United States. Under those tax treaties, the withholding rate on interest payments to the foreign parent sometimes can be significantly less than the withholding rate on dividend distributions. Consequently, planning the appropriate mix of debt and equity of the subsidiary (and assuring that the characterization will be respected by the Internal Revenue Service) can be important.

(iv) *Intercompany Loans*

As is the case with other dealings between a foreign parent company and its United States subsidiary, the terms and conditions of intercompany indebtedness must be commercially reasonable, in order for the arrangement to be respected as “debt” for United States income tax purposes. If an advance, nominally designated as “debt,” is recharacterized as an “equity” infusion from the foreign parent company, payments from the subsidiary that would otherwise be treated as “interest” may be reclassified as “dividends,” which may subject the subsidiary to a greater income tax burden and related interest and penalties for failing to treat the item correctly.

Assuming that the other terms and conditions of an advance are sufficient to support “debt” characterization, the loan must carry a market interest rate. The Internal Revenue Service publishes a series of “applicable Federal rates” (adjusted monthly based on market conditions) which serve as guidelines for determining whether the interest rate on indebtedness between affiliated companies is comparable to the terms that would be offered by independent third party lenders. If the interest rate on a debt instrument equals or exceeds the applicable federal rate, then the interest rate will be deemed to be arm’s-length. If an interest rate is too low or is not paid, the Internal Revenue Service can impute a higher interest rate.

d. *Direct Operations in the United States*

(i) *If No Applicable Tax Treaty*

If a foreign company operates directly in the United States (through a branch or division in the United States, rather than through a corporate subsidiary) and the home country of the foreign company is not a party to a tax treaty with the United States, then the Internal Revenue Code alone will govern the taxation of income that is “effectively connected” with the United States operations. The rules are intended to tax that income from the foreign company’s “considerable, continuous and regular” activities in the United States in a manner similar to the way taxes are computed for other United States taxpayers. The difficulty in applying that methodology, however, is in determining which items of income and expense are properly attributed to the foreign company’s United States operations. That inquiry requires a complicated segregation and apportionment analysis of the worldwide operations of the foreign company. The results necessarily are inexact and can sometimes be unpredictable.

(ii) *If a Tax Treaty Is in Effect*

If the home country of a foreign company is a party to a tax treaty with the United States, different rules apply. While each treaty has its own unique features, most United States tax treaties impose United States taxation only if a foreign company operates directly in the United States through a “permanent establishment.” The determination of “permanent establishment” status is somewhat different than determining whether a foreign company is “doing business” in the non-treaty context.

Generally, a foreign company will have a permanent establishment in the United States if it conducts business through a fixed place of business (or is deemed to be doing so through a dependent agent or otherwise). The mere ownership of an interest in a United States subsidiary will not result in the foreign parent company being deemed to have a permanent establishment in the United States.

Treaties typically list the types of activities that do not create permanent establishment status. Those permitted activities usually include (i) maintaining a store of goods in the United States, (ii) use of a true “independent agent” that does not have the authority to accept contracts or bind the foreign company and (iii) preparatory or auxiliary activities.

If a foreign company has a permanent establishment in the United States, it will be taxed on its income attributable to United States sources. Analysis of income “attributable to” United States operations also is somewhat different than determining “effectively connected” income in the non-treaty context.

(iii) *Entity Classification*

When a foreign company is directly subject to United States taxation, its classification for United States tax purposes will be important. Typically, the foreign company will be classified either as a “corporation” or as a “partnership.” That determination is complex, however, and sometimes unpredictable. For instance, there are a number of entities that are presumed to be corporations for United States tax purposes. Those include entities such as German Aktiengesellschafts and United Kingdom Public Limited Companies, but even these entities may be classified as partnerships under certain circumstances. Some entities can elect their classification for United States tax purposes.

(iv) *Branch Profits Tax*

If a foreign company operates directly in the United States either through a “permanent establishment” (under a treaty) or by conducting a United States “trade or business” (if no treaty is in place), it will be required to file a tax return in the United States, and it will be subject to United States income tax on the income attributable to its United States operations.

As noted above, the United States tax system seeks to create rough equality between various methods of conducting business in the United States, so that one method is not preferred, artificially, over another. In keeping with that principle, the “branch profits” tax imposes a surcharge on the earnings and profits generated by the United States operation of a foreign company in an amount comparable to the withholding tax imposed on dividends repatriated by a United States corporate subsidiary to its foreign parent company.

Since branches or divisions of a foreign company are not independent legal entities, they technically do not remit “dividends” to their “parent.” They are one and the same legal entity. Consequently, the branch profits tax is an attempt to tax (in a fashion similar to withholding on dividends from a subsidiary) the actual or “deemed” repatriation of net profits from the United States division to the home country of the foreign company.

Tax treaties can reduce or eliminate the impact of the branch profits tax, in much the same way as those treaties affect withholding on interest and dividend payments made by a United States subsidiary to its foreign parent company. Consequently, application of the branch profits tax must also be evaluated in light of any applicable treaties.

The above description of the branch profits tax is, by its nature, simplistic. Its actual operations are extremely complex and can result in tax consequences far different from those intuitively expected.

e. Transfer Pricing Regulations

All countries are aware that manipulation of the prices of goods and services by affiliated companies can reduce or eliminate taxable income in the adversely affected jurisdictions. “Transfer pricing” rules are designed to require that intercompany transactions be conducted on an arm’s length basis at fair market values. If not, a transaction can be recast and repriced to reflect fair market rates. Obviously, any such reformulation can result in higher taxable income in one of the affected jurisdictions (and higher taxes than might have been previously reported).

As an example, if a foreign parent company sells machinery produced in its home country to its wholly-owned United States subsidiary at an inflated price, the profits of the United States subsidiary will be artificially depressed, resulting in lower income taxes paid in the United States than would otherwise be the case if the transaction was priced on an arm’s length basis. The transfer pricing rules permit the Internal Revenue Service to reconstruct the pricing arrangements to reflect the lower fair market value of the machinery, which will result in higher profits for the United States subsidiary and additional tax owed to the United States government.

Transfer pricing restrictions can be inflexible and in some cases can produce inequitable consequences. Consequently, careful planning, analysis and documentation are required to anticipate and deal properly with the transfer pricing rules. Advance planning can significantly reduce the expense and aggravation of dealing with an Internal Revenue Service audit of transfer pricing issues and possible increased tax liability.

f. State and Local Taxation

Most states impose an income tax on enterprises conducting business within that state’s jurisdiction. As is the case with federal taxes, state income taxes are intended to be applied in a uniform manner to all businesses operating in the state, regardless of whether they are owned or operated by foreign companies. In many cases, the state income taxes are based on the federal tax calculations, so that the state’s income tax is computed by applying a tax rate to the portion of the federally-computed tax base attributable to that state.

In addition to income taxes, many state and local governments impose other taxes that must be dealt with when conducting operations in those jurisdictions. Those taxes include sales and use taxes, employment taxes, franchise taxes, local taxes on real and personal property and various excise taxes.

g. Foreign Investment in Real Property Tax Act (FIRPTA)

The Foreign Investment in Real Property Tax Act (FIRPTA) assures that profits from the sale of ownership of interests in real property located in the United States are taxed in the United States, whether or not the holders of the interests are doing business or have a permanent establishment in the United States. FIRPTA has an extensive reach (covering direct and indirect ownership interests in real property) and an expansive definition of what constitutes a United States “real property interest.” If such an interest is disposed of, tax must be withheld from the proceeds by the purchaser at the closing of the transaction and remitted to the Internal Revenue Service. For additional detail on FIRPTA, *see* Chapter 17, *Owning and Leasing Facilities in the United States*.

h. Foreign Nationals in the United States

If nationals of a foreign country are involved in the United States operations and are present in the United States for more than 183 days during a calendar year (or if they become lawful permanent residents of the United States), those individuals will be considered United States residents for federal income tax purposes and will be required to file United States tax returns. Obviously, those foreign

nationals also will have to comply with the immigration laws of the United States, which are discussed in Chapter 10, *Immigration Law*.

Nationals of a foreign country should also be aware that the United States has an estate tax and a gift tax that applies to individuals that are domiciled in the United States. Applicability differs from the income tax rules. Any foreign national that will be in the United States for an extended period of time should consult with professional advisors concerning the possible application of the estate and gift tax statutes to that individual.

i. Partnership and Limited Liability Company Operations

In the United States, partnerships and limited liability companies do not pay federal income taxes in their own right. Rather, the entity's taxable profits or losses are allocated to the entity's owners (partners in the case of partnerships, and members in the case of limited liability companies), who in turn report their respective shares of profits or losses on their income tax returns. This allocation of profits or losses to the partners or members is accomplished by the partnership or limited liability company filing forms with the Internal Revenue Service that show all the owners' names and United States taxpayer identification numbers. Thus, investing through a partnership or limited liability company results in less anonymity to the investor than does investing through a corporation.

Most states follow the same treatment as applies for federal income tax purposes, although a few states impose income taxes directly on partnerships or limited liability companies (rather than on their partners or members) in a fashion comparable to corporations. Any trade or business activities of partnerships and limited liability companies are treated as being conducted by the partners or members, which can have adverse tax consequences to foreign investors. The federal and state tax laws applicable to foreign investment in United States partnerships and limited liability companies can be exceedingly complex, requiring guidance at an early stage from knowledgeable and experienced tax advisors.

Chapter 7

Regulation of Foreign Companies

a. *Laws and Regulations*

Laws enacted by federal, state and local governments regulate business activity for the collective benefit of all people living and doing business in the United States. Those laws range from required inspection of foods to restrictions against employment discrimination and are implemented, in many cases, through governmental agencies. Foreign companies doing business in the United States are subject to the same laws and restrictions as are United States companies. In addition, however, certain federal laws and regulations are uniquely applicable to foreign companies doing business in the United States. The following material is a sample, not an exhaustive listing, of certain federal laws and regulations of which foreign companies should be aware, as well as a brief introduction to state and local laws and regulations.

b. *International Investment and Trade in Services Survey Act*

The United States Congress enacted the International Investment and Trade in Services Survey Act (IISA) to collect information about foreign investment in the United States. Since the survey is designed merely to gather data, it does not regulate foreign investment, and all information collected under the IISA is held in confidence. For further detail concerning the IISA, *see* Chapter 12, ***United States Business Acquisitions***.

Based on data received, the BEA compiles a Benchmark Survey of Foreign Direct Investment in the United States, which can be obtained on request from the BEA. The survey data is sorted by industry as well as by country and can be quite instructive as to relative investment flows in the United States.

c. *Agricultural Foreign Investment Disclosure Act*

In order to determine the extent to which agricultural lands in the United States are being acquired by foreign interests, the United States Congress enacted a law known as the Agricultural Foreign Investment Disclosure Act (AFIDA). AFIDA applies to any foreign person that acquires, transfers or holds an interest (other than a security interest) in agricultural land (land used for agriculture, forestry or timber production). Within 90 days after the acquisition or transfer of the interest in agricultural land (or within 90 days of the point at which land becomes agricultural land), the foreign person must file a report with the Secretary of Agriculture. Failing to file (or filing an incomplete, misleading or false report) can result in civil penalties of up to 25% of the fair market value of the foreign person's interest in the land. Unlike the IISA, information collected from AFIDA filings is available for public inspection and will be disclosed to the applicable state's Department of Agriculture within 6 months of filing.

d. *Currency & Foreign Transactions Reporting Act*

In order to monitor currency flows in the United States and their effect on the integrity of the United States financial system, the United States Congress enacted the Currency & Foreign Transactions Reporting Act (CFTRA). Under the CFTRA, the import or export of monetary instruments (including currency, traveler's checks, checks and money orders) in excess of \$10,000 by any person, including a foreign person, must be reported to United States Customs and Border Protection at the time of entry to or departure from the United States. Failure to file can result in civil penalties, in addition to the seizure and forfeiture of monetary instruments in transit. Criminal penalties also apply to willful violators.

e. Hart-Scott-Rodino Antitrust Improvements Act

Evaluating antitrust implications of large acquisition transactions is the purpose of the Hart-Scott-Rodino Antitrust Improvements Act (HSR Act). The HSR Act has broad application (which may surprise many foreign companies) and requires that the acquiring company, as well as the entity to be acquired, file advance notification with the Federal Trade Commission and the Department of Justice of the intended acquisition, assuming certain threshold amounts are satisfied. In general, the HSR Act is triggered if (i) the parties' assets or annual sales exceed certain thresholds, (ii) the value of the acquisition exceeds certain minimum amounts and (iii) sufficient assets or revenue are attributable to the United States. For further detail concerning the applicability of the HSR Act, *see* Chapter 12, *United States Business Acquisitions*.

f. Committee on Foreign Investment in the United States (CFIUS)

The Exon-Florio amendment to the 1950 Defense Production Act permits the President of the United States to prohibit any foreign acquisition, merger or takeover of a United States company that might threaten the national security of the United States or that involves critical infrastructure so vital to the United States that its incapacitation or destruction would have a debilitating impact on national security. Although the law does not define "national security," Congress has indicated that the term is to be interpreted broadly and that all industries are subject to the Exon-Florio Amendment. Unlike other federal regulations, filings made under the Exon-Florio amendment are voluntary. Any filing would be submitted to the Committee on Foreign Investment in the United States (CFIUS), which advises the President on these matters. Counsel should be sought regarding the advisability of making these filings. For further detail concerning the applicability of CFIUS, *see* Chapter 12, *United States Business Acquisitions*.

g. Foreign Agents Registration Act

The Foreign Agents Registration Act (FARA) was enacted by the United States Congress in order to gather information concerning the activities of foreign interests seeking to influence United States public opinion, policy or laws. FARA requires that agents engaged in certain political, public relations, solicitation or representation activities on behalf of foreign principals must file a registration statement with the Attorney General within ten days of agreeing to become an agent and before performing any activities for the foreign principal. Agents engaged in lobbying activities are specifically exempted from FARA but must register under the Lobbying Disclosure Act. Some exceptions are made in the cases of diplomatic or councilor officers (or their staff members), officials of foreign governments and persons engaging in private, religious, scholastic, scientific and other nonpolitical activities. All informational materials disseminated by agents who are required to file a registration statement must be conspicuously labeled to indicate that they are distributed by the agent on behalf of the foreign principal and must be filed with the Attorney General within 48 hours of such materials' transmittal (which filings are made available for public inspection). Failure to comply with the Act can result in criminal penalties.

h. Securities Laws

Securities laws have been enacted by the federal government to regulate the offer and sale of securities for the protection of investors and to assure the integrity of the United States financial markets. That protection is afforded through requirements that material information about an investment be disclosed to investors. Securities laws can be implicated even if no sale is ultimately made.

At the federal level, the Securities Act of 1933 prohibits the issuance of "securities" unless the issuer has either registered those securities with the United States Securities and Exchange Commission or an exemption from that registration requirement is available. While stock in a corporation is the typical example of a "security," the definition of the term "security" is very broad and has been held to include investment contracts and various other investment interests.

Consequently, whenever an activity of a foreign company involves the offer or sale of securities in or through the United States markets (including securities that originate outside the United States), advice should be obtained concerning implications under United States securities laws. In many cases, exemptions or expedited approvals are available, but absent the advice of professional advisors, they should not be assumed or relied on.

Most states also have securities laws that complement the federal laws and protect the residents of those particular states. Those state laws are sometimes referred to as “Blue Sky Laws.” As is the case with the federal regime, states typically have exemptions and abbreviated filing requirements available in certain circumstances. Applicability of those laws and their relationship to federal laws should be reviewed with securities law counsel.

i. Government Contracting

Foreign companies should also be aware that certain contracts with governmental agencies require advance clearance and information disclosure. For instance, in conjunction with agreements with the federal government for services or products that involve access authorization, the United States Department of Energy requires disclosure concerning foreign ownership, control or influence, for the purpose of evaluating whether foreign company involvement or influence may pose an undue risk to the common defense or security of the United States.

j. Local and State Regulation

i. Qualification to Do Business

The state in which a business entity is formed is known as its state of “domicile.” In the event that a business operates in other jurisdictions (for instance, a corporation domiciled in Delaware that does business, as well, in New York), the business will be required to “qualify” to do business in those other jurisdictions (New York in the above example). The theory is that if a business wishes to take advantage of the markets in a particular state, it should have to comply with certain registration and regulatory requirements of that state.

Qualifying to do business typically requires the filing of an “application for authority to do business” in the subject state. That application discloses basic information about the business and designates a registered agent and registered office in the state, comparable to the procedure in the state of domicile (*see* Chapter 4, *Corporation Formation and Operation*). Qualification typically requires payment of an initial fee, with annual reports and additional fees due annually.

Whether the activities of a business in a particular state rise to the level of “doing business” in that state (thereby requiring qualification) is sometimes a difficult question to resolve. There is no bright line test. However, many states require qualification if a business is present in the subject state for a period of 30 days or more or has consistent and regular contacts with the state. Because these rules vary from state to state and with the circumstances of a particular business activity, business qualification issues should be reviewed by professional advisors.

The level of activity in a state also will have implications for taxation purposes. Activity that may not be sufficient to require qualification to do business in a particular state may, nonetheless, be enough to impose tax reporting and payment obligations in that state. Minimal contacts sometimes are sufficient for imposition of state taxation.

ii. *Business Licenses and Permits*

Businesses operating in a state sometimes are required to comply with various state and local licensing regulations, depending on the type of business being conducted and the location of the operations. Some states have an information office that provides answers to common questions concerning business licenses and permits. These information offices usually can be contacted through the state's Secretary of State web site home page.

Most local municipalities require (i) that business licenses be obtained from the local tax authority and (ii) that personal property used in the business be listed annually with the local tax office for local property tax purposes (a tax based on the value of those assets). As well, most local municipalities have zoning, fire and building code requirements that must be complied with when operating a business in those jurisdictions.

(iii) *Professional Licensing*

In many states, professional services (engineering, architectural, health related, etc.) are subject to special regulation. If a foreign company will be providing these types of services (even if only ancillary to the sale of products being manufactured), a review of potentially applicable regulations should be undertaken.

Chapter 8

Sales Representatives and Agents

a. Necessity of Clear Contract Terms

Many foreign companies enter United States markets by first using independent sales representatives. Depending on those results, the progression is then to use true direct agents and ultimately to full scale operations in the United States. As noted in Chapter 6, *Taxation of United States Operations*, as a foreign company moves along that continuum, exposure to United States taxation and other regulatory requirements increases commensurately.

Wherever a foreign company is on that continuum, it is critical that the contractual relationship with any sales representative or agent be clear, unambiguous and comprehensive. Misunderstandings frequently occur over the functions of sales representatives and agents and their compensation arrangements.

While some common law and statutory provisions bear on those relationships, the contract between the parties largely will determine their relative rights. Foreign companies sometimes discover that they have entered into arrangements exposing them to continuing commission obligations for significant periods following termination of relationships with unsatisfactory sales representatives or agents. These types of problems can be avoided if the contract is clear on the important points of the relationship. The balance of this Chapter describes a few areas of particular concern.

b. Status of Representative or Agent

If the sales representative or agent is to be an “independent contractor,” and not a direct agent or employee of the foreign company, the contract should so state. This will be important when determining, for United States tax purposes, whether a foreign company has a “permanent establishment” in the United States. As noted in Chapter 6, *Taxation of United States Operations*, one factor used in determining whether a permanent establishment exists is whether an agent of the foreign company is present in the United States and has the power to contract on behalf of the foreign company or take other comparable action. If a foreign company wishes to avoid permanent establishment status, the contract with the sales representative or agent should expressly exclude those powers.

c. Scope of Duties

Each contract should be clear about (i) the expected duties of the sales representative or agent, (ii) how long those services will be performed, (iii) how the arrangement will terminate and (iv) the residual obligations of each party, if any. If the sales representative or agent fails to comply with those expectations, the contract should provide that the foreign company has the right to terminate the contract.

In some circumstances, a longer term commitment from the sales representative or agent may be advisable. The foreign company may be investing a significant amount of capital in its United States initiative, and it may be financially exposed unless the sales representative or agent performs the services required for a sufficient time to enable the foreign company to gain a foothold. In other circumstances, a brief engagement may be all that is needed to initiate United States operations.

Duties of a sales representative or agent that should be documented in a contract include:

- making contact, either in person or by telephone, with identified potential customers

- making presentations with respect to specific products
- identifying and informing the foreign company of potential customers
- making on-site presentations to existing and potential customers
- submitting regular sales reports, information pertaining to new account development and credit information
- assisting in collection of delinquent accounts
- complying with all applicable laws and regulations
- committing affirmatively not to take any action that would adversely affect the foreign company's business reputation
- performing other functions and services necessary to obtain the most effective possible distribution of the subject products

d. Commission Arrangements

In any contract with a sales representative or agent, one of the most important provisions is that addressing the computation and payment of commissions or other compensation. If the method of computation or manner of payment is unclear or incomplete, a dispute will inevitably result.

Sales representatives and agents sometimes prepare the contract themselves and present it to the foreign company. Those agreements usually favor the sales representative or agent and lack a clear computation methodology for commissions or compensation. It is advisable for a foreign company to develop its own standardized agreement for use in dealing with sales representatives and agents. The contract can be fair to both sides but clear and comprehensive in its coverage.

Because commission and compensation provisions typically involve mathematical computations, costly errors can result if the components of the calculation are not precisely described. For instance, if a contract provides that commission will be paid on "all sales" of the foreign company, but the contract does not define that term precisely, the sales representative or agent may claim commission on sales that are not directly procured by the sales representative or agent. In many cases, the foreign company intends to pay commissions only for sales (i) that are procured primarily through the efforts of the sales representative or agent, (ii) which have closed during the term of the contract and (iii) for which the foreign company has been paid.

Similarly, considerable differences can arise when computing commissions or compensation using gross sales, net sales, collected sales, invoiced sales or shipped sales. Failure to address precisely the base for commissions or compensation is an invitation to litigation. A foreign company also should be careful to carve out, from any commission arrangements, sales to existing customers of the foreign company that are not linked to the efforts of the sales representative or agent.

Many lawsuits have been filed in the United States over entitlement to, and computation of, sales commissions. These disputes may be avoided if the commission provisions of the contract are drafted with precision.

e. Termination Provisions

Contentious situations may arise if the contract is not clear about residual obligations, if any, of the foreign company and the sales representative or agent following termination. If commissions are to

be paid for orders that are processed following termination, that contingency must be clear and unambiguous. Residual payment obligations may sound innocent at the outset of a contract, but they can be quite costly and problematic if the relationship with the sales representative or agent is less than satisfactory. A foreign company may have to replace the sales representative or agent with another and may find itself faced with paying two commissions on the same set of sales. Expectations should also be documented regarding return of property of the foreign company by the sales representative or agent, confidentiality, tampering with contractual relationships of the foreign company and related matters.

f. Disputes

When disputes over commissions and compensation arrangements arise, the reaction of the foreign company might be to refuse to pay any amount until the dispute is resolved. Unfortunately, in many jurisdictions, failure of a company to pay commissions that are due and owing may subject the company to double or triple damages and payment of the legal fees of the sales representative or agent. The question, of course, is whether the commissions are due and payable. If they are found to be owing (under state statutes that require prompt payment of any commissions due following termination), those additional penalties and charges may be assessed against the company. This is another reason to make sure that the contract terms provide abundant flexibility for the foreign company to assess performance of the sales representative or agent and adjust compensation accordingly, or terminate the agreement without residual liability.

It is also advisable to provide for the method of resolving disputes. Possibilities range from non-binding mediation, to binding arbitration, to full scale litigation. Factors that bear on the choice include the leverage of a particular party, each party's resistance to publicity and the relative cost of the alternatives. The decision should be made with advice of counsel. *See Chapter 11, Supplier and Customer Contracts*, for further discussion of dispute resolution alternatives and applicable international conventions.

g. Other Provisions

Other provisions that a foreign company should consider including in a contract with a sales representative or agent are those dealing with (i) restrictions on representing competing products during and after the contract, (ii) representations and warranties by the sales representative or agent that there are no restrictions precluding their performance under the contract, (iii) confidential and proprietary information, (iv) the territory covered by the contract, (v) limitations on statements that can be made by the sales representative or agent about the products, (vi) restrictions on the ability of the sales representative or agent to bind the foreign company, (vii) terms and conditions on which orders are to be submitted, (viii) indemnity provisions, (ix) expense reimbursement policies, (x) nondisclosure requirements and (xi) confirmation of independent contractor status.

Chapter 9

Employment Law (Federal and State)

a. Employment Relationship

The relationship between an employer and employee in the United States can be very different than that in other countries. This Chapter sets forth some of the peculiarities of United States employment law of which foreign companies may not be fully aware. Employment law is an area that requires particular attention, since there are many pitfalls that can be very costly if not handled properly. For that reason, prudent foreign companies setting up operations in the United States find it helpful to have someone familiar with United States employment regulations on the staff of the human resources department and to have professional advisors available to deal with employment law issues that inevitably arise with little or no notice.

As a general proposition, the labor pool in the United States is quite mobile, and competition for skilled employees, at times, can be intense. Employment relationships in the United States are fluid by nature and do not have the social compact characteristics present in some other countries (*i.e.*, lifetime employment, social fabric services, etc.). Although some employers and employees in the United States may hope that their relationship will be one that lasts for an employee's entire career, that typically is neither the expectation nor the experience. Whether employment relationships end voluntarily or involuntarily, terminations do occur on a regular basis, and the employer should be prepared for that eventuality and the issues that arise from it.

b. At Will Employees

Unlike some countries, United States jurisdictions typically do not have laws that grant to employees the right of continued employment. Employees are presumed to be employed "at will" (no commitment by either employer or employee for any duration, and termination permitted for any reason), unless otherwise provided in a contract between the employer and employee. In an "at will" state (absent a contract), an employer or employee may terminate an employee's employment, generally, without notice and without having to establish cause for the termination.

As is the case with all general rules, however, there are exceptions. Later in this Chapter, various federal and state laws in the United States are discussed that prohibit termination of employment by an employer if that termination is for an impermissible discriminatory purpose. As well, mass terminations may require some advance notice (discussed below).

c. Employment Contracts and Employee Handbooks

While written employment contracts are not required by statute, they may be desirable, since they document agreements and expectations about issues important to the business. For example, it is customary to require executive employees to enter into comprehensive employment agreements that address items such as (i) compensation, (ii) bonus arrangements, (iii) evaluations, (iv) duties, (v) exclusive services, (vi) noncompetition provisions, (vii) rights to intellectual property, (viii) compliance with contracts of previous employers, (ix) duration of the contract, (x) manner and situations in which the contract can be terminated and (xi) protection of confidential information.

While comprehensive employment contracts may not be appropriate for rank and file employees, it may be important to subject those employees to short agreements protecting the company's rights in confidential information and intellectual property developed by those employees during their employment.

Although employment contracts have their benefits, they must be carefully drafted to maintain an employee's at-will status. Specifically, contracts with a specific term of employment (for example, two years), or contracts which only allow termination for just cause, act to make eliminate the presumption of at-will employment. For employers with a unionized work force, the collective bargaining agreement between the employer and the union will invariably include a "just cause" provision which takes the employment of the union employees outside the at-will realm.

Many employers find it advisable to have an Employee Handbook that details the various policies and procedures of the company with which employees are required to comply as a condition of employment. Those handbooks, if properly drafted, updated and enforced by the employer, can help protect the employer from liability when employment disputes arise.

In order for obligations and restrictions to be enforceable against employees, the employees must have received adequate "consideration" at the time they agree to be bound. For instance, if an executive, who has signed a comprehensive employment agreement and has been operating under that agreement for some time, is later asked to sign a supplemental noncompetition provision that was not discussed or contemplated at the time the executive and the company entered into the initial employment agreement, that supplemental agreement may not be enforceable against the executive, unless the executive is given some additional consideration at the time the additional restriction is imposed. It is very important that employers deal with restrictions and obligations at the outset of the employment relationship and document those items carefully in a written employment contract.

d. Restrictive Covenants

In order to protect the viability of a business, it is sometimes advisable to impose restrictions on certain employees, preventing them from competing with the business during and after they have left employment. The theory is that the employer has gone to great lengths to develop customer relationships, a market for its products, and trade secret or confidential information. Employees who work for the company are beneficiaries of that investment, and it would be unfair for an employee to learn about the business, its customers, and its trade secrets and then abruptly leave to set up a competing business.

If properly structured, these types of restrictive covenants are enforceable in most jurisdictions in the United States. However, many jurisdictions construe them very narrowly and look for reasons not to enforce them. Consequently, it is important that any such restrictions be carefully drafted to fit within the acceptable parameters of the particular jurisdiction in which they will be enforced.

As noted earlier, these types of restrictions require consideration in order to be enforceable. Consequently, many states require that they should be imposed as part of the initial employment offer, or be accompanied by significant additional consideration if imposed after an employee has commenced performing services. Further, most jurisdictions require that the restrictions be reasonable in both (i) time of duration and (ii) the territory in which the restrictions apply.

e. Intellectual Property Provisions

In the United States, many discoveries and inventions made by employees in the ordinary course of their employment typically are the property of the employer. However, it is advisable to specifically so provide in an employment agreement in order to confirm and expand the scope of the employer's rights. The employer should expressly obtain all rights in inventions or intellectual property that are related in any way to the business or proprietary property of the employer and that arise during the employee's tenure with the employer (and for a reasonable period after employment terminates). This type of provision requires that the employee cooperate with the employer in obtaining patent and other intellectual property protection.

f. Independent Contractor and Employee Classification

Federal tax and labor laws in the United States distinguish between workers who are “employees” and those who are “independent contractors.” The bias of those laws, however, is in favor of classifying workers as employees, because that classification assures the government that some “employer” will comply with all of the income tax withholding, employment tax contribution and labor law requirements applicable in an employer/employee relationship. Companies engaging true independent contractors are not subject to those regulations.

Because of the regulatory bias towards “employee” classification, a business must be very cautious when treating a worker or representative as an independent contractor. If an independent contractor is determined by a regulatory agency to actually be an employee, the employer may be liable for (i) income taxes not withheld and remitted to the government, (ii) employment taxes required to be paid by the employer and (iii) any claims under labor laws applicable to employers and employees (*i.e.*, overtime pay requirements, pension plan inclusion, etc.).

If a company intends to deal with a worker or service provider as an independent contractor, advice from counsel should be sought to determine whether independent contractor status will be upheld. There are a number of tests and factors that apply in making that determination, many of which focus on the degree of control that the company exercises over the tasks to be performed by the purported independent contractor. Workers need not be full time to be considered “employees.” When in doubt, it is always safest to treat as “employees” workers and service providers who are integral parts of a business.

In many instances, highly sought after sales representatives will insist on being treated as independent contractors, because they do not want income taxes withheld from their compensation or to be otherwise considered part of the employment force of the employer. In many cases, that is appropriate, but a company should make its determination without regard to the opinion or preference of the sales representative, since substantial penalties may be imposed on the company if the sales representative is misclassified. Sales representatives that work for numerous manufacturers on an unsupervised and independent basis may properly be classified as independent contractors, but even those persons may cross the line into employee status if their work approaches exclusivity with a particular manufacturer or their operations are controlled to a significant degree by a company they represent.

g. Labor Unions

The presence of labor unions in the United States varies significantly from one region of the country to another and from one industry to another. In many southern states, for instance, labor unions do not have a significant presence, and most businesses are staffed with a non-union workforce. However, there are certain industries even in those states that are unionized. Various states, especially those in the Northeast, such as Pennsylvania, Massachusetts, New Jersey and New York, are heavily unionized.

If labor unions do represent some or all of the workers at a facility, the employer is required to comply with a number of federal and state laws and regulations that require collective bargaining in the administration of the employer/employee relationship. The National Labor Relations Act, which is a federal statute, protects the rights of employees to organize and bargain collectively and prohibits unfair labor practices.

Even though an employer’s workforce might not currently be represented by a labor union, organizing campaigns are undertaken by unions on occasion. The employer is subject to a number of laws and regulations that govern how the company deals with those organizing efforts and the

restrictions on contacts with employees during the campaign. These matters should be discussed in detail with the company's professional advisors.

h. Anti-discrimination Laws

Even if an employer is operating under "at will" employment principles, and without contract restrictions, federal and state laws in the United States protect certain classes of individuals from discriminatory actions in the employment context. Those laws are many and varied, but a sampling of federal laws is as follows:

Federal Law (common name)	Summary	Coverage
Age Discrimination in Employment Act of 1967 (ADEA) 29 U.S.C. §§ 621 et seq.	Prohibits discrimination in the hiring, compensation, termination, terms, conditions and privileges of employment of individuals 40 years or older, based on age.	Employers engaged in industry affecting commerce who have 20 or more employees for each working day of 20 or more calendar weeks in the current or preceding year.
Americans with Disabilities Act of 1990 (ADA) 42 U.S.C. §§ 12101 et seq.	Prohibits discrimination in the hiring, compensation, termination, terms, conditions and privileges of employment of individuals with disabilities under Title I of the Act; other titles forbid discrimination in public services, public accommodations and telecommunications.	Employers engaged in industry affecting commerce who have 15 or more employees for each working day of 20 or more calendar weeks in current or preceding year.
Civil Rights Act of 1964 (Title VII) 42 U.S.C. §§ 2000e et seq.	Prohibits discrimination in the hiring, compensation, termination, terms, conditions and privileges of employment, based on race, color, religion, sex or national origin; also provides for action against sexual harassment.	Employers engaged in industry affecting commerce who have 15 or more employees for each working day of 20 or more calendar weeks in the current or preceding year.

i. Other Employment Based Laws

In addition to the laws referenced above, there are numbers of additional potentially applicable federal and state laws that govern the employer/employee relationship. A sampling of federal laws includes the following:

Federal Law (common name)	Summary	Coverage
Employee Retirement Income Security Act of 1974 (ERISA) 29 U.S.C. §§ 1001 et seq.	Protects the interests of employees and beneficiaries in employee benefit plans and employee welfare plans, such as pension and health care plans.	Employers engaged in commerce who establish or maintain welfare benefit plans such as life and health insurance, or a plan, fund or program, that provides retirement income to workers or results in the deferral of income by employees until or past retirement or their termination.

Fair Labor Standards Act of 1938 (FLSA) 29 U.S.C. §§ 201 et seq.	Establishes the federal minimum wage; requires that non-exempt employees be paid overtime for hours worked over 40 per week; requires that employees in hazardous occupations be over the age of 18; forbids employment of minors under age 14, and imposes limitations on employment of minors aged 14-15.	Employers who are engaged in commerce or production of goods for commerce. Other technical provisions may apply.
Equal Pay Act of 1963 (EPA) 29 U.S.C. § 206(d).	Requires that men and women in the same establishment receive equal pay for equal work on jobs that require equal skill, effort and responsibility and that are performed under similar working conditions.	Employers subject to the FLSA, but coverage includes employees who are exempt from the FLSA's overtime provisions.
Family and Medical Leave Act of 1993 (FMLA) 29 U.S.C. §§ 2601 et seq. 5 U.S.C. 6381 et seq.	Requires employers to provide up to 12 weeks of unpaid leave in a 12-month period to "eligible" employees for the birth, adoption or foster care placement of a child; to care for a spouse, child or parent who has a serious health condition; and to care for themselves due to a serious health condition.	Employers engaged in industry affecting commerce who have 50 or more employees within a 75-mile radius for each working day of 20 or more calendar weeks in the current or preceding year.
Immigration Reform and Control Act 8 U.S.C. § 1324a et seq.	Prohibits employment of unauthorized aliens and requires verification of employees' right to work in the United States	All employers.
Occupational Safety and Health Act of 1970 (OSHA) 29 U.S.C. §§ 651 et seq.	Requires employers to provide employees with a work place free from recognized hazards likely to cause death or serious injury and comply with occupational safety and health standards.	Employers engaged in businesses affecting interstate commerce.

Other federal laws include:

- Employee Polygraph Protection Act (EPPA)
- Health Insurance Portability and Accountability Act (HIPAA)
- Pregnancy Discrimination Act of 1978 (PDA)
- Rehabilitation Act of 1973
- Uniform Services Employment and Re-Employment Rights Act (USERRA)
- Vietnam Era Veterans' Readjustment Assistance Act of 1974 and Executive Order 11701.

j. Employee Benefits

While there are very few employee benefits that are mandated by state or federal law, a foreign company should be aware that an employer has an obligation to pay a certain percentage of an employee's wage base as a contribution to the United States Social Security program. While the Social Security program is operated by the federal government, funding comes from both employers and

employees. The employee's portion of the contribution typically is deducted from the pay of the employee at regular intervals in the same manner and at the same time as income tax is withheld. The employer then remits to the federal government those amounts, along with the employer's contribution. Any funds that are withheld from employee paychecks for these purposes are considered "trust" funds. If they are not properly remitted to the federal government, both the employer and the responsible executives of the employer (personally) may be liable for payment of those funds. Employers also must pay a certain percentage of an employee's wages to the state unemployment compensation fund in the state where the employee works.

Foreign companies also should be aware of each state's workers compensation program. All states require that most employers obtain workers compensation insurance, which is intended to compensate employees for job related injuries. If the employer is in compliance with the state's workers compensation guidelines, an employee's exclusive remedy against the employer for work-related injuries is through that program, absent egregious circumstances.

As noted above, mandatory employee benefits are few in the United States, but there are a wide array of employee benefits that employers can voluntarily offer to their employees generally, as well as to specific individual employees or groups of employees. It is beyond the scope of this Guidebook to fully describe the complete universe of employee benefits, but the following material is a brief description of some of the more popular benefits considered by employers. Again, none of these benefits are required to be provided to employees, but they can be offered if in keeping with the employment philosophy of the employer or required to remain competitive with other employers.

Some employee benefits are "tax advantaged" while others are not. Tax advantaged benefits typically provide the employer with a tax deduction, with the employees receiving the benefit with deferred or no tax consequence. Tax advantages are intended to encourage employers to adopt those benefits for their employees.

One type of employee benefit is the "qualified" retirement plan, which is a private supplement to the federal Social Security system. There are many variants of qualified retirement plans, but the essential elements are that (i) they are established and maintained by the employer, (ii) the employer's contributions to the plans (within certain limits) are deductible by the employer, (iii) contributions by employees may be made on a pre-tax basis, and (iv) investment appreciation of contributions are not taxed currently (although they may be when withdrawn).

While a number of employers still maintain qualified plans to which only the employer contributes and over which the employer exercises complete investment control, the most popular type of qualified plan these days is one in which (i) the employer and employee both contribute to the plan, (ii) a separate account is maintained for each employee and (iii) the employee determines how the monies in that employee's account are invested (choosing from a menu of investments provided by the employer). These plans are sometimes referred to as "defined contribution" plans, and one of the most popular types is known as a "401(k)" plan (named for the Internal Revenue Code section which authorizes that particular variant).

Other tax advantaged employee benefits include various medical, dental and insurance plans. Fringe benefits that, depending on the circumstances, may or may not carry tax advantages (depending upon how they are structured) include parking benefits, discount programs, and automobile and transportation packages.

When considering various employee benefits, the employer should be aware that many of the tax advantaged benefit programs require that they be operated in a nondiscriminatory manner (as between various classes of employees). Those programs also usually require significant documentation and reporting, in order for the employer and employees to avail themselves of the tax advantages.

k. Plant Closing and Layoff Regulations

Although it may never be applicable to them, all employers should be aware of the Worker Adjustment and Retraining Notification Act (WARN). With certain exceptions, WARN requires that an employer give 60 days advance notification of (i) a plant closing or mass layoff that will result in significant job terminations at a single site of employment, (ii) an employment layoff exceeding 6 months at a single site of employment or (iii) (in certain circumstances) a reduction in work hours. WARN is applicable to employers who employ 100 or more employees, and at least 50 employees must be affected by plant closing.

The rules of WARN are complicated and can apply in unusual ways. For instance, there is a “look back” and “look forward” testing period which requires that all layoffs within that test period be evaluated to determine whether the threshold requirements have been met for application of WARN. If WARN applies, advance notices of the terminations must be given to the employees, or monetary penalties may be assessed. Application of WARN can be quite problematic in the acquisition context, especially if the new owner of the business plans to make personnel adjustments. If the former owner of the business also has made employment adjustments during the testing period, the combined activities may trigger application of WARN. Whenever significant layoffs or personnel adjustments are contemplated by an employer, professional advisors familiar with WARN should be consulted.

In addition to WARN, roughly one-third of the states have their own plant closing laws. Many times, these plant closing laws apply even where WARN does not. Thus, an employer should be aware of both WARN and the law, if any, in the state(s) in which it operates and must comply with both WARN and the state law, to the extent applicable.

l. Employee Severance

Federal and state laws do not require payment of severance to terminated employees. Severance in the United States is governed by contract. Accordingly, an employer will be obligated to pay severance only if it has contractually committed to make such payments. Employers who do obligate themselves by contract to pay severance should be aware that severance pay is often regarded as wages, and failure to pay severance may subject the employer not only to liability for the amount unpaid, but for attorney’s fees and liquidated damages as well.

Chapter 10

Immigration Law

a. Central Role of Immigration Laws

In the United States, a company can legally employ only workers who are citizens of the United States or who have proper authorization from the United States Citizenship and Immigration Service (USCIS). Work authorization for non-citizens typically is evidenced by an appropriate (i) visa, (ii) employment authorization document or (iii) permanent resident alien card – affectionately known as the “green card” (although it is not green).

Companies often do not recognize immigration issues inherent in the employment context and can unknowingly violate the Immigration and Nationality Act (INA) or the Immigration Reform and Control Act (IRCA), the latter being enacted to end unauthorized employment of foreign nationals. The basic concepts of those laws are highlighted below, as are the visa programs most commonly used by businesses in order to legally employ foreign nationals.

Foreign nationals who work without authorization are subject to possible fines and expulsion, as well as disqualification from various visa categories and from permanent residency. Companies who employ unauthorized workers may suffer the penalties discussed at the end of this Chapter. For those reasons, it is very important that companies doing business in the United States have a working knowledge of United States immigration laws and access to professional advisors that can deal with the particulars.

b. Immigration Status

The first step in evaluating an individual’s rights and obligations while present in the United States is to determine that person’s immigration “status.” The primary status classifications under the immigration laws of the United States are as follows:

(i) Undocumented Aliens

An undocumented “alien” is an individual that is not a United States citizen (a foreign national) who has entered the United States illegally (*i.e.*, without a visa -- a stamp in the passport that signifies that a consular official believes that the person is eligible to apply for admission in a particular nonimmigrant category -- or other entry documentation). An undocumented alien cannot be legally employed.

(ii) Nonimmigrants

A nonimmigrant is a person granted status to enter the United States for a temporary period of time and for a specified purpose (*i.e.*, to visit, study, work in a particular job, etc.). Companies may only employ nonimmigrants that (i) have been granted entry to work, usually for a specific company, or (ii) have been granted entry to study and the educational institution authorizes work pursuant to a training program.

Generally, nonimmigrants are issued a visa stamp in the passport. Time and entry restrictions in visas vary greatly. Visas may be valid for as few as 30 days or for many years. It is important to note that the period of validity of a visa is not the same as the period of authorized stay once in the United States. The authorized stay noted on the small white I-94 Arrival/Departure card (presented to the foreign national by the immigration inspector upon entry into the United States) may be longer or shorter than

the validity period of the visa. The I-94 card, not the visa stamp, is the measure of a nonimmigrant's status, purpose of entry, and duration of stay.

(iii) *Out of Status Persons*

Any foreign national who fails to comply with the terms on which he or she is admitted into the United States, as determined by a visa and the I-94 Arrival/Departure card, is "out of status." This can occur if a foreign national stays in the United States beyond the expiration date of their status or if that person engages in employment in the United States that has not been authorized by the USCIS.

A foreign national who is out of status is normally accumulating unlawful presence. If a foreign national stays in the United States more than 180 days longer than authorized, he or she will have accumulated unlawful presence and may be barred from returning to the United States for 3 years. A person who is found to have been unlawfully present for 365 days or more may be barred from returning to the United States for 10 years.

Consequently, it is very important that companies be aware of the authorized period of stay granted to a nonimmigrant worker, as it would be unfortunate to lose valuable employees simply due to oversight. Unless an extension has been obtained or is pending, when a foreign national stays in the United States after the expiration date on the I-94 card, their visa will expire and they will have to apply for a new visa in his or her home country.

(iv) *Permanent Residents (Immigrants)*

Permanent resident status gives a foreign national immigrant classification and the right to live and work in the United States, without time or other limitations. Permanent resident status is most commonly obtained through close family ties to a United States citizen (or another permanent resident) or through employment in the United States (usually based on a job with a United States employer). Permanent residents hold permanent resident alien "green" cards.

(v) *United States Citizens*

United States citizenship can be acquired by birth in the United States or birth outside the United States to at least one parent who is a United States citizen. Citizenship can also be acquired through a process called naturalization in which an individual adopts the principles of the United States government and meets other requirements prescribed by law.

c. *Common Commercial Nonimmigrant Visas*

Nonimmigrant visas are temporary visas, even though they may allow a foreign national to remain in the United States for a varying period of years (depending on the visa). The purpose for which a foreign national seeks entry into the United States will determine the type of visa required. Visas are categorized by letters of the alphabet, which coincide with subsections of the INA. Set forth below are visa types that are most commonly used by businesses in the United States.

(i) *B-1 "Business Visitor" Visa /B-2 "Tourist" Visa*

A B visa may be issued when (i) the visit to the United States is temporary, (ii) entry is sought for a business purpose or for pleasure, (iii) the foreign national will not perform services for the benefit of a United States business or be paid from a United States source and (iv) the foreign national maintains a foreign residence that he or she has no intention of abandoning. The B visa is not an employment authorizing visa, although under some circumstances it allows the foreign national to conduct certain business activities. The length of the period of admission will vary with purpose, need, and expected length of stay. B visa holders may apply for extensions of the period of admission in cases that have

resulted from unexpected events outside the person's control, which prevent the person from leaving the United States.

(ii) *Visa Waiver*

Citizens of specified countries whose citizens the United States does not fear are unlikely to return home are eligible to enter the United States for periods of up to 90 days without first obtaining a visa. Broadly speaking, such individuals can enter for any purpose which would be appropriate under a B visa. Entries under the visa waiver cannot be extended past 90 days except in very limited circumstances.

(iii) *TN Status*

Sponsoring companies may employ citizens of Canada and Mexico under "Trade NAFTA" or "TN" status, to perform jobs that are included in the list of designated, primarily professional positions under the North American Free Trade Agreement (NAFTA). The TN application process can be uncomplicated and can be used by companies who employ Mexican or Canadian citizens to work for temporary periods. Under limited circumstances, individuals seeking to engage in self-employed temporary business activities in the United States may also seek admission under the TN category. The process is quite simple, with an individual providing an offer of employment or other engagement by a United States employer, and evidence of the required educational or work experience background for the particular NAFTA classification. The usual requirement of prior approval from the Department of Labor or an employer petition from the USCIS are eliminated under NAFTA. Citizens of Canada can apply at any border post or airport with an inspection station. Citizens of Mexico must apply through a United States Consulate. Canadian citizens granted TN "status" receive a notation in their passport as well as an I-94 card while a Mexican citizen will receive a visa stamp. They may only work for their sponsoring United States employer.

The TN classification allows foreign professionals admission to the United States for a maximum initial period of 3 years, which can be extended in three-year increments with no outside limit on the total period of stay. The only limitation is that the purpose of stay must continue to be temporary. If an individual intends to seek permanent residency, another classification generally is explored. The worker's spouse and children under 21 are eligible to enter in TD status, but that status does not permit employment in the United States.

(iv) *H-1B Specialty Worker Visa*

Foreign nationals may be admitted in H-1B status as "specialty occupation workers" if they possess a United States bachelor's degree in a specialized field of study, an equivalent foreign degree, or equivalent years of experience, and work in a profession that requires the degree. H-1B visa holders are only authorized to work for their sponsoring employer. The H-1B classification requires Department of Labor approval pursuant to a Labor Condition Application (LCA). The LCA process ensures that the employer is paying the foreign worker the prevailing wage for the job and that the employer has notified its workforce of the intent to hire a foreign national for the position. H-1B visas are also subject to yearly quotas.

An H-1B visa is initially issued for a 3-year period and may be extended for an additional 3 years. The worker's spouse and children under 21 may be included in the petition and are eligible for H-4 visas. The H-4 visas will allow the family members to travel with the H-1B employee to the United States but will not permit employment in the United States.

Citizens of Australia may apply for what has been designated as an E-3 visa, but whose requirements and procedures are very similar to the H-1B visa.

(v) *L Intracompany Transferee Visa*

The L visa is available to foreign companies seeking to bring their executive, management or specialized knowledge employees to the United States. The basic requirements for obtaining an L-1 -- intracompany transferee -- visa are that the subject employee must (i) have worked for the foreign company for a continuous period of 1 year within the last 3 years, (ii) have been employed abroad in an executive or managerial position or a position involving “specialized knowledge” and (iii) be coming to the United States company in one of those capacities. The company for which the employee has worked for a year abroad must be the same company or a subsidiary, affiliate or branch of the United States company, and the hiring company must continue to do business abroad during the entire period of the employee’s stay in the United States as an L-1 transferee. L-1 employees may only work for their sponsoring employer.

The maximum initial period of stay in L status is 3 years, except that employees transferring to a new office that has been in operation for less than 1 year are admitted for only 1 year. Extensions of stay up to a total of 7 years can be obtained for executives or managers and up to 5 years for specialized knowledge personnel. The L-1 employee’s spouse and children under 21 may be included in the petition and are eligible for L-2 visas. The L-2 visas will allow the family members to travel with the employee to the United States. The L-2 spouse may obtain employment authorization to work in the United States, but other dependents may not work.

(vi) *E-1 Treaty Trader/E-2 Treaty Investor Visa*

The E visa category extends immigration benefits to foreign companies who invest or conduct trade in the United States and are from countries that have a treaty with the United States. Prerequisites for E visa eligibility are that (i) a treaty exist between the United States and the home country of the foreign company (treaty country), (ii) citizens or nationals of the treaty country are the majority owners or control the subject company and (iii) the person applying for an E visa be a national of the treaty country.

In addition to the above requirements there are special requirements that must be met to obtain an E-1 Treaty Trader visa or an E-2 Treaty Investor visa. Generally, for an E-1 visa, the foreign national employee must serve in a managerial or “essential skills” capacity, and the company must be engaged in a “substantial” “trade” that is “principally” between the United States and the treaty country. For an E-2 visa, the foreign national must fill a key role as an “essential skills” employee or as the investor who will direct and develop an “active substantial investment” — a real operating enterprise producing some service or commodity. There is also an expectation that the investment will create jobs in the United States and that it is not merely to support the investor and his or her family. The E visa holder is only authorized to work for the sponsoring employer.

The E visa holder’s spouse and children under 21 may be included in the petition and are eligible for E visas that allow the family members to travel with the employee to the United States. The E spouse may obtain employment authorization to work in the United States, but other dependents may not work.

The E visa category has a few special benefits not available to other nonimmigrant categories. While the E visa is initially granted for 2 years, it can be extended almost indefinitely, as long as the visa holder agrees to leave the United States at the end of the period of authorized stay, including extensions. Also, rather than applying at the USCIS, the application for an E visa is made at the United States embassy in the foreign national’s home country.

(vii) *O-1 Visa*

Foreign nationals of “extraordinary ability” in the sciences, arts, education and business may qualify for an O visa, when those individuals have an extensive publication record, have made

outstanding contributions to their field of endeavor according to their peers, and have membership in professional associations that require outstanding achievement of their members or can satisfy other criteria set forth in regulations. The initial period of stay in O status can be up to 3 years, with extensions granted in increments of up to 3 years. O visa holders are authorized to work only for their sponsoring employers. Like the E and the L, the O-1 application is rather document intensive.

d. Employment-Based Immigrant Status

The immigrant process is commonly referred to as the “green card” process and, in many cases, requires the foreign national to have an offer of employment and be sponsored by a United States employer. In other cases, the “extraordinary ability” category as an example, a foreign national may apply based on his or her Nobel Peace Prize-type accomplishments, without the need of a sponsor. In any event, the immigrant program does operate with numerical limitations and various preferences.

There are two basic approaches to obtaining employment based permanent residence. The first has very similar requirements to the L-1 executive or manager (but not specialized knowledge) requirements, and an executive or manager who qualifies for an L-1 executive or manager visa will usually equally qualify for permanent residence.

The second generally available approach is the labor certification process. Under this approach, before a company can file with the USCIS to have a foreign national classified as a qualified immigrant, it must first apply to the Department of Labor (DOL) for certification that qualified United States citizens or permanent residents have been recruited for the position and are unavailable. In other words, the USCIS requires that companies test the market to determine whether qualified United States citizens or permanent residents are available to perform the functions for which the company desires to permanently employ a foreign national. If the recruitment yields a qualified and available citizen of the United States, the DOL will not certify the petition to allow the company to permanently hire the foreign national.

The green card process can be very time-consuming and frequently becomes backlogged and delayed at the DOL and USCIS. Consequently, companies that desire to obtain immigrant status for, and permanently employ, foreign nationals should seek counsel early in the nonimmigrant’s stay, rather than waiting to the end of the period of stay.

e. Compliance with Immigration Laws

In 1986, the Immigration Reform and Control Act (IRCA) was enacted by the United States Congress to end employment of unauthorized foreign nationals. Since the IRCA was enacted, employers have been obligated to verify that workers they hire are authorized to work in the United States. IRCA impacts employers in the following ways:

- Employers are prohibited from knowingly hiring and employing foreign nationals who do not have authorization.
- Employers are required to verify the identity and employment eligibility of all employees hired after November 6, 1986 and to retain proof of that verification.
- Employers are prohibited from participating in discriminatory hiring and employment practices.

Non-compliant employers are subject to fines and/or imprisonment for violations of the IRCA.

Chapter 11

Supplier and Customer Contracts

a. Necessity of Clear Contract Terms

As mentioned throughout this Guidebook, contracts are “king” in the United States when it comes to determining the relative rights of parties in commercial dealings. Accordingly, clear and comprehensive contracts with customers and suppliers are fundamental to successful operations in the United States. Some of the best commercial relationships can sour quickly if misunderstandings arise over items that could have been quickly discussed, resolved and documented at the outset of the relationship.

Contracts with suppliers and customers, at a minimum, should describe with particularity (i) what is to be produced, (ii) order procedures, (iii) the required specifications, (iv) the expected delivery terms, (v) warranty obligations, (vi) prices and payment terms, (vii) confidentiality requirements, (viii) indemnification obligations, (ix) official language of the contract and (x) governing law. This Chapter addresses a number of the provisions customarily present in customer and supplier agreements. However, it does not provide a complete listing, or extensive coverage of those items mentioned. Contract provisions take shape based on the circumstances of each arrangement and are fashioned, to some degree, by the relative bargaining power and market leverage that one party has with respect to the other.

b. Applicable Law and Conventions

If a commercial relationship with a customer or supplier is to be conducted wholly within the United States, the law of the state specified in the contract (typically, the state of domicile of one of the parties) generally will govern the relationship. Each state would apply statutory law (principally the Uniform Commercial Code as adopted by that state) and its common law. As mentioned in Chapter 2, *Operations in the United States*, laws are sometimes general in nature. Consequently, even though some guidance may be provided by law, material terms of the arrangement should be set forth in detail in the contract.

In the event that a contract may be performed, in whole or in part, outside the United States, the law applicable to the contract may not necessarily be the law specified in the contract. It is important to know that the United States is a party to the United Nations Convention on Contracts for the International Sale of Goods (CISG). The CISG (also referred to as the Vienna Convention) is a multi-national treaty that provides, in the context of the sale of goods, guidelines on interpreting international contracts.

If both parties to an international contract are domiciled in CISG contracting states, the contract must expressly state that the CISG does not apply. Otherwise, the CISG will automatically apply to the contract.

For example, if a United States company and an Australian company enter into a contract for the sale of goods in the United States, the CISG will automatically apply (since both of those countries are CISG contracting states), unless the parties have expressly stated in the contract that the CISG will not apply. No reference to the CISG is required in order for it to apply. It automatically applies, unless otherwise expressly excepted.

While the CISG is similar in scope to the Uniform Commercial Code (as enacted by each state), there are significant differences which include the following:

- **Formation of a contract occurs much more easily under the CISG.** Under the Uniform Commercial Code, most contracts for the sale of goods must be in writing. Under the CISG, a contract need not be in writing and can be established by oral communication.
- **A buyer's ability to reject non-conforming goods is much more limited under the CISG.** Under the Uniform Commercial Code, the buyer may reject goods if they do not conform in all respects to the contract. Under the CISG, non-conforming goods may be rejected only if the non-conformity deprives the buyer of "substantially" what the buyer was entitled to expect and the seller should have foreseen this result.
- **A seller has a broader right to cure non-conformities under the CISG.** Under the Uniform Commercial Code, a seller has the right to cure a non-conformity only if the time for delivery has not passed. Under the CISG, the seller may cure a non-conformity even after the time for delivery has passed if, in general, the seller can do so without "unreasonable" delay and without causing the buyer "unreasonable" inconvenience.

The countries listed on [Attachment 1](#) at the end of this Guidebook have adopted the CISG (subject to various reservations and declarations by certain of the countries.) The list includes most countries of the industrialized world (note, however, the conspicuous absence of the United Kingdom). The CISG has not been adopted in its entirety by every contracting state. Some have opted out of, or modified, certain provisions. For example, Argentina departs by requiring that a contract for the sale of goods must be in writing.

c. When Is the Contract Formed

A contract is formed and binding on the parties when an offer has been made and accepted. Exactly when that occurs, and the exact terms and conditions of the contract, are sometimes open to debate and can result in significant disputes between parties. Confusion as to this fundamental event is compounded by the various forms and correspondence that are traded among the parties during the negotiation process (proposals, letters of intent, deal points, order forms, acknowledgment forms, invoices, etc.). E-mails alone may contain sufficient terms to create a contract. Parties to negotiations need to be alert to the fact that their actions at any point during that process may be sufficient to create a binding contract (even though that might not have been their intention).

Consequently, a party to any negotiation should carefully prepare any documentation or correspondence coming from it or its agents, and carefully review comparable material coming from the other party, to assure that no contract is formed until the party is ready for that event to occur. The documentation should be designed so that no contract will be formed until all of the material terms have been agreed to, the party is ready to proceed and the appropriate signatures of authorized representatives have been obtained (on the contract itself or in accordance with applicable electronic signature laws).

Note, also, that, even if a contract has not been formed, parties to a negotiation still may have some potential liability to each other based on equitable principles. For instance, if one party to a negotiation relies to its detriment on a representation or encouragement provided by the other party, with the other party's knowledge and acquiescence (e.g., by making significant purchases of raw materials or making capital investments in tooling, based on expectations improperly created by the other party), the party detrimentally affected may be able to recover its damages from the other party. Consequently, it is important to make sure that, in the negotiation process, no unintended representations are made and that the correspondence is clear that no binding obligations arise (and no actions should be taken or are authorized) until a definitive agreement is signed by all parties.

d. Delivery Terms

Dealing with delivery arrangements would seem to be a simple matter. Unfortunately, significant disputes can arise if the parties are not clear as to their respective responsibilities. Because of the risk of confusion, buyers and sellers of goods typically rely on standardized terminology (summary acronyms such as FOB, FAS, EXW, etc.). Those terms carry definitional context and have been developed to describe the rights and duties of the parties under various delivery arrangements. However, they do not cover every aspect of a delivery arrangement or all types of deliveries. Consequently, it is important to embellish on those standardized terms in the contract, in order to assure that all delivery particulars are covered.

In the United States, the Official Text of the Uniform Commercial Code has repealed defined shipping terms in favor of express agreement; however, the Uniform Commercial Code in effect in most states still contains certain defined standardized terms. For instance, the Delaware Uniform Commercial Code defines the following delivery terms that can be used in applicable contracts:

- **F.O.B.** (if place of shipment, seller bears the risk and expense of placing goods in the possession of a carrier; if place of destination, seller bears the risk and expense of transporting goods to the named place)
- **F.A.S.** (seller bears the risk and expense of delivering goods alongside the vessel and must obtain, and tender a receipt for issuance of, a bill of lading)
- **C.I.F.** (seller bears the risk and expense of freight and insurance in delivering goods to a named destination)

In the context of transactions involving international deliveries, the International Chamber of Commerce has developed standard terms known as “Incoterms.” First published in 1936, and updated periodically, “Incoterms” (an abbreviation for “International Commercial Terms”) are a compilation of 13 standard delivery and transportation “key words.” Each Incoterm allocates responsibilities in a different way with respect to:

- packaging, marketing, counting, weighing and similar requirements
- export clearance (including licenses and other authorizations and customs formalities)
- carriage of goods from the seller to the buyer (including procurement of insurance)
- where delivery takes place
- notice requirements (including desired carriers, delivery time and proof of delivery)
- when risk of loss transfers
- division of costs
- import clearance (including licenses and other authorizations and customs formalities)

When their use is appropriate, Incoterms can eliminate the necessity of drafting pages of contract provisions to cover details of those transportation responsibilities. Each Incoterm, by its nature, encompasses most of the details of those concepts. An international contract need simply reference the appropriate Incoterm, state the applicable destination or place of origin and refer to the appropriate version of Incoterms. For most international buyers and sellers, the use of Incoterms has become commonplace.

Incoterms are divided into the following four main categories:

- **EXW** (minimum obligations imposed on the seller – make the goods available to the buyer at the seller's premises)
- **FCA, FAS and FOB** (the seller is to transfer the goods to a carrier, free of risk and expense to the buyer)
- **CFR, CIF, CPT and CIP** (the seller is to bear certain costs even after the cross over point for assumption of the risk of loss)
- **DAF, DES, DEQ, DDU and DDP** (maximum obligations imposed on the seller – the goods must arrive at a stated destination)

Differences between Incoterms falling within each of the last three categories above generally relate to (i) the mode of transport and who arranges for carriage (*e.g.*, under FCA, carriage is arranged by the seller on behalf of the buyer and applies to any mode of transport, while, under FAS, carriage is arranged by the buyer and is used only for sea transport), (ii) incremental costs (*e.g.*, under DDP, import duty is paid by the seller) and (iii) risk of loss transfer (*e.g.*, under FAS, risk of loss transfers when the goods are placed alongside the ship, while, under FOB, risk of loss transfers when the goods pass the ship's rail).

It is important to note that the Uniform Commercial Code definitions of particular terms (to the extent they have not been repealed in a particular state) may vary somewhat from the definition in Incoterms, and the coverage of Uniform Commercial Code provisions sometimes is not as comprehensive as Incoterms. Each contract should specify which definitional provisions will apply when using a standardized delivery term (Uniform Commercial Code or Incoterms), and additional amplifying terms and conditions should be set forth in the contract.

e. Acceptance and Payment Terms

The contract should provide specifications and standards applicable to the subject goods or services. If goods or services are not delivered in the required condition, a procedure for dealing with that occurrence should be set forth in detail. Possible alternatives might include (i) permitting the buyer to unilaterally reject the goods or services with no continuing payment obligation, (ii) a procedure in which the buyer notifies the seller of any inadequacies, with the seller having the right to cure the problem within a specified time period or (iii) the buyer having an obligation to make payment upon delivery, unless the goods or services are significantly impaired, with minor adjustments to be handled by the parties through a dispute resolution process. Each situation will require its own particular solution. It should also be kept in mind that, if the contract is not explicit with respect to these type items, the law applicable to the contract (*i.e.*, the Uniform Commercial Code, the CISG, etc.) may provide default guidance on certain aspects of the matter (which may, or may not, be what the parties intend).

It is also important that payment terms and conditions be precisely set forth in the contract. Basic issues to be covered include (i) procedures for issuing invoices, (ii) when the obligation for payment arises (*i.e.*, receipt of the invoice, delivery date, etc.), (iii) any discounts for prompt payment, (iv) whether and how interest will accrue on unpaid invoices, (v) the extent to which any supplemental charges will accrue, (vi) the method of payment (*e.g.*, wire transfer, certified funds, regular bank check, etc.), (vii) invoice content (*e.g.*, detail on specific products and services, applicable taxes such as sales and use taxes, etc.), (viii) the currency in which payment is to be made, (ix) reimbursable expenses and (x) the right, if any, to offset payment amounts against other obligations between the parties.

f. Termination Provisions

Supplier and customer contracts must contain a provision dealing with the length of time that the relationship will remain in place. As is the case with other contract provisions, there are innumerable possibilities, including (i) a date certain, (ii) an “evergreen” provision, automatically perpetuating a fixed continuing term, absent advance notice of termination, (iii) a date certain, with the option for one or both of the parties to unilaterally extend the arrangement to another date certain, (iv) an open-ended term, with either party having the right to terminate the contract on advance notice or (v) a fixed initial term, with an automatic extension, on an open-ended basis, with the right to terminate after the initial term on advance notice.

An additional provision is necessary to address the possibility of a default or breach under the agreement. The contract might grant to the non-defaulting party (i) the right to terminate the contract unilaterally and immediately upon notice to the defaulting party, (ii) the right to terminate the contract after notifying the defaulting party of the breach and permitting the defaulting party a specified period in which to cure the breach or (iii) some variation of those rights.

A clear definition of a “default” or “breach” should be contained in the contract. Those terms can encompass a broad array of actions or omissions by the parties including (i) a material default in performance, (ii) any default in performance, regardless of materiality, (iii) misrepresentations or false or misleading statements, (iv) insolvency or bankruptcy or (v) other actions or omissions that may result in material harm to a party.

Change of ownership of a party might also be an event that warrants termination, since the other party might not be comfortable continuing to do business with the successor owners. The definition of a “change of ownership” can be as elaborate as the circumstances require and can include situations in which less than a majority of a party’s ownership changes.

It is also important to document steps that the parties are required to take after the contract terminates. Inevitably, there are loose ends to be attended to such as (i) unfilled orders, (ii) payment obligations, (iii) property of a party in the possession of the other, (iv) residual third party obligations and duties and (v) post-termination restrictions.

g. Dispute Resolution

It is advisable at the outset of a commercial arrangement to consider how disputes will be resolved, if they arise. The typical menu of dispute resolution procedures includes negotiation, mediation, arbitration and litigation. Whether one, or some combination, of these alternatives should apply is a decision for the parties, but the process should be described in the contract.

A contract might provide that, if either party declares the existence of a dispute, the parties must follow a prescribed negotiation procedure. Negotiations can be conducted at successive hierarchical levels within each party’s organization, with the goal being resolution within a specified period of time. If each party’s representatives at each level have the authority to resolve the dispute, the matter hopefully can be expeditiously disposed of, without significant embarrassment to a party and without damaging the commercial relationship.

If something more formal is appropriate, the parties could consider a requirement that the dispute be submitted to mediation. An independent third party mediator, provided by the American Arbitration Association (AAA), the International Chamber of Commerce (ICC) or comparable organization, could be appointed to hear the facts of the dispute and to actively assist the parties in reaching resolution. Mediation injects a third party into the process, but the results of the mediation typically are not binding on the parties.

Arbitration, like mediation, involves the participation of a third party arbitrator, but the procedure is more structured than mediation. Rules of arbitration facilitate a more in-depth review of the situation. The parties should choose, in advance, the arbitration rules that will be applicable (*e.g.*, those provided by the AAA, ICC or other body). Arbitration can be either binding or non-binding, as the parties may agree in the contract.

The positive aspects of arbitration include the following:

- An international treaty, referred to as the New York Convention, requires that courts in treaty countries recognize and enforce arbitral awards. The countries listed on Attachment 2 at the end of this Guidebook are parties to the New York Convention (subject to various reservations and declarations by certain of the countries). There is no analogous general international treaty for enforcement of judgments resulting from court litigation.
- Use of an internationally recognized arbitral organization, such as the AAA or the ICC, may prove to be helpful in enforcing an arbitral judgment, as it will appear more likely that the arbitration was conducted fairly and appropriately.
- The parties may require that the arbitration be confidential, which could be critical if the dispute involves trade secrets.
- The arbitration provision might require that the arbitrator have expertise in a particular industry, making it more likely that the arbitrator will understand the intricacies of the dispute.
- The parties can continue to perform under the contract while the dispute is being resolved. Often, if litigation is involved, performance under the contract will completely cease until the litigation is concluded.

The fourth type of dispute resolution process is litigation. The principal benefit of litigation is its structured and imposing nature and the right to appeal decisions to higher courts. Parties tend to feel the gravity of matters more acutely in court proceedings, which are public and conducted in accordance with sometimes elaborate, established procedures. For additional discussion of the United States court system, *see* Chapter 2, *Operations in the United States*.

Instructive information about arbitration and mediation services can be obtained from AAA and ICC as follows:

American Arbitration Association
1633 Broadway, 10th Floor
New York, New York 10019
Tel.: +1-212-716-5800
Fax: +1-212-716-5905
www.adr.org

International Chamber of Commerce
Secretariat of the ICC International
Court of Arbitration
38, Cours Albert 1er
75008 Paris France
Tel: +33-1-49-53-2828
Fax: +33-1-49-53-2959
www.iccwbo.org

h. Warranties and Liability Limits

A supplier or customer contract should address the extent to which goods or services carry warranties. A buyer may want extensive warranties with few limitations, such as a blanket warranty that the goods or services will operate and perform in accordance with the requirements set forth in the contract and for their intended purpose, without reservation.

On the other hand, a seller may want to limit its warranties only to those explicitly expressed by the seller, with other warranties expressly excluded, including implied warranties of merchantability and fitness for a particular purpose or any warranties otherwise arising in the ordinary course of dealing or trade. In some states, certain warranties may not be disclaimed, especially when consumer goods are involved.

Similarly, the seller will seek to limit the scope of potential liability for its breach by excluding indirect, incidental, consequential, punitive or other special damages and lost profits. Some sellers propose specified dollar amount caps on liability of any kind. The buyer, on the other hand, typically will resist those limitations, preferring that all possible avenues of recovery against the seller be preserved.

i. Other Provisions

Other customary provisions in supplier and customer contracts include those dealing with (i) production support and cost reduction, (ii) tax obligations, (iii) import and export compliance, (iv) confidential information, (v) indemnification procedures, (vi) compliance with applicable laws, (vii) time being of the essence, (viii) acts of God and strikes, (ix) effects of incidental waivers of rights, (x) third party beneficiaries, (xi) contract amendment procedures, (xii) restrictions on assigning rights or duties under the contract and (xiii) the ability of affiliated companies to join in the arrangements.

Chapter 12

United States Business Acquisitions

In deciding whether to make a significant investment in the United States, a foreign company will start up new operations *de novo* (typically referred to as a “greenfield” investment), acquire a business that is operating in the United States or establish a joint venture that will undertake the “greenfield” investment or business acquisition. The reasons for choosing one method over the other will be varied and will depend on the specific circumstances. By choosing a “greenfield” investment, the foreign company will establish an entity in the United States and obtain the appropriate licenses and permits. This process is discussed in further detail elsewhere in this Guidebook (including Chapter 3, *Entity Selection*), and flow charts laying out the formation process of a corporation and a limited liability company are attached to the end of this Guidebook as Attachment 3. For a discussion of joint ventures, see Chapter 13, *United States Joint Ventures*. This Chapter will discuss acquisitions of businesses operating in the United States.

The acquisition of a United States company (Target Company) by a foreign company or by a subsidiary entity owned by a foreign company (Buyer) typically involves the Buyer purchasing either all of the equity ownership of the Target Company (a stock acquisition) or substantially all of the assets of the Target Company (an asset acquisition). This Chapter is intended to highlight a few of the fundamental issues that arise in an acquisition in the United States. However, many of the other Chapters also address particular issues that will be faced in any such acquisition (see, e.g., Chapter 9, *Employment Law (Federal and State)*, which discusses mandatory notices under WARN).

Note also that a flow chart laying out the general process for the acquisition of a United States business is attached at the end of this Guidebook as Attachment 4. Although the process for no two acquisitions will be exactly alike, the flow chart in Attachment 4 seeks to provide a visual primer of the customary steps in acquiring a United States business.

a. Due Diligence

No matter how simple or complex an acquisition transaction might be, the Buyer must analyze thoroughly the business operations and financial condition of the Target Company. This is known as the “due diligence” process. The Buyer should develop a “due diligence checklist” that can serve as a guide for uncovering pertinent documents and information concerning the Target Company. Typically, a due diligence checklist covers areas relating to corporate governance, financial matters, important contracts, real and personal property, intellectual property, environmental issues, employee matters, tax matters, litigation and government issues. Thorough due diligence analysis at the outset of a transaction can identify potential problems that, if not discovered and dealt with before the transaction is closed, can be problematic for the profitable operation of the acquired business. For example, if such problems are identified at the outset, the Buyer’s business and legal teams can assess alternative solutions, which may include, among other things, changing the form of the transaction (from a stock acquisition to an asset acquisition, or vice versa), obtaining consents from implicated parties, negotiating an indemnification from the Target Company, disclosing Target Company regulatory noncompliance to applicable government authorities or agreeing to take on potential risks in exchange for obtaining more favorable terms in other areas, including a reduction in the purchase price.

b. Documentation

Business acquisition agreements in the United States tend to be lengthier and more detailed than is sometimes customary in other countries. Hopefully, this minimizes potential disputes following the

closing of the transaction by having the parties thoroughly discuss and resolve the significant issues of the transaction and clearly articulate that resolution in the definitive acquisition agreement.

A typical acquisition agreement contains the following general categories of provisions, along with others that address the specific circumstances of the transaction:

(i) *Recitals or Statement of Purpose*

The recitals or statement of purpose provide the background for the acquisition, describing the general purpose and intent of the parties.

(ii) *Definitions*

If numerous terms used in the agreement have defined meanings, it is often helpful to segregate all the definitions in a separate section of the agreement.

(iii) *Purchase and Sale*

The most important section of the agreement addresses the purchase and sale of the subject stock or assets, as applicable. This section will set forth (i) exactly what is being purchased and sold, (ii) the purchase price and (iii) the mechanics of the sale. The provisions can be quite complicated and may involve, for example, working capital computations that determine the price at the closing or adjust the price after the closing. If the transaction is structured as a stock acquisition, it could be effected through a variety of mechanisms, including a cash transaction or a merger. The deposit of a portion of the purchase price into escrow might also be addressed, which would provide a source of funds to satisfy potential indemnification claims of the Buyer (discussed below).

(iv) *Representations and Warranties*

This section sets forth representations and warranties of the Target Company, and perhaps its shareholders, on which the Buyer will rely. Topics covered may be very comprehensive and typically include: (i) the title to and condition of the assets, (ii) existence of litigation, (iii) accuracy of financial statements, (iv) status of customer and supplier relations, (v) authority to conclude the transaction, (vi) absence of conflicts, (vii) status of employee relations, (viii) violations of laws and (ix) absence of material tax issues. If the Target Company (or its shareholders) cannot make a representation because it would be untrue, then those exceptions are listed on a schedule that is attached to the acquisition agreement.

Representations and warranties (i) bring to light potential liabilities and problems associated with the business; (ii) confirm exactly what is being purchased; (iii) allocate risk for liabilities that may not be known by either party (*e.g.*, a spill of hazardous substances by a prior owner of the property on which the business is being operated); (iv) force the Target Company (or its shareholders) to think carefully about all aspects of its business; (v) provide a basis for imposition of indemnification liability (see discussion below) and (vi) assist the Buyer in due diligence and in understanding the business of the Target Company. In essence, they serve to justify the purchase price and any required adjustments to be made after the closing.

(v) *Interim and Post-Closing Covenants*

Certain covenants and agreements may be necessary when the parties are signing the agreement on one date but closing the transaction on a later date. Typical pre-closing covenants might include those covering (i) restrictions on the Target Company's operation of the business, other than in the ordinary course of business, (ii) cooperation in completing any remaining due diligence and (iii) a "no-shop" requirement (prohibiting the Target Company and its shareholders from soliciting or entertaining offers to purchase from third parties).

Covenants applicable to the post-closing period might also be required and could include those covering (i) non-competition obligations (to prevent the Target Company or selling shareholders from competing with the Buyer in the same business that it just sold), (ii) confidentiality requirements, (iii) tax return procedures for any periods that straddle the closing date and (iv) the handling of existing litigation or other claims against the Target Company.

(vi) *Conditions to Closing*

This category lists the conditions that each party must satisfy in order to trigger the other party's obligation to close the acquisition. Common conditions include (i) delivery of officer certificates confirming the accuracy of the representations and warranties and necessary approval of the shareholders of the Target Company, (ii) obtaining consents to the acquisition from governmental authorities and third parties (such as landlords and licensors), (iii) delivery of other agreements (such as employment agreements, escrow agreements, non-competition agreements, etc.), (iv) satisfaction of any financing contingencies and (v) delivery of bills of sale and assignments (if an asset acquisition) or stock certificates (if a stock acquisition).

(vii) *Termination*

If signing and closing will not occur simultaneously, the acquisition agreement should contain a provision that permits a party to terminate the agreement prior to the closing if the other party breaches the agreement or if closing simply has not occurred by a certain date (the latter often referred to as a "drop-dead" date).

(viii) *Indemnification*

The indemnification section provides the responsibilities and remedies of the parties in the event of a breach of the acquisition agreement or a claim made by a third party relating to the business acquired. It typically addresses (i) the limits, if any, on the indemnification obligations of the Target Company or its owners, such as a cap on liability, (ii) a deductible or "basket" that must be exceeded before indemnification obligations will commence, (iii) a time limit for bringing indemnification claims and (iv) procedures for notice and defending third party claims for which indemnification is being sought.

(ix) *Miscellaneous*

This category addresses miscellaneous matters such as notice arrangements, governing laws, procedures for modification of the agreement and methods for resolving disputes. Even though denoted as "miscellaneous," these provisions have important implications and require careful review.

It is important that the parties not be bound until all details have been worked out to the satisfaction of the parties and the parties have signed the acquisition agreement. Preliminary documents such as "letters of intent," "memoranda of understanding" and "heads of agreement" can be helpful in the process of negotiating the acquisition agreement, but use of those preliminary documents should be reviewed by legal counsel, because, if not properly drafted, they may, in fact, be binding on the parties.

c. *Stock Acquisitions*

Stock acquisitions can be accomplished by a direct purchase of the stock of the Target Company or by a merger or share exchange. While direct purchase is a common method of stock acquisition, tax and other considerations may prompt use of a merger or share exchange. For instance, if there are numerous shareholders of the Target Company, a merger may be preferred, in order to ensure that the Buyer is able to obtain 100% of the equity of the Target Company. In a merger, minority shareholders can be forced to give up their equity ownership (“squeezed out”), so long as they are equitably treated.

Although this Chapter refers to “stock” being acquired (the case where the Target Company is a corporation), if the Target Company is a limited liability company or partnership, the equivalent concept would involve the acquisition of the “membership interests” or “partnership interests” of the Target Company.

Among the advantages of structuring a business acquisition as a stock purchase, rather than as an asset purchase, are the following:

- the business of the Target Company remains intact in the same business entity in which it has historically been operated
- the acquisition is simpler, because the transfer is accomplished by merely conveying the ownership interest (stock, membership interest or partnership interest)
- no transfer of physical assets is required, because the Target Company continues in operation, owning the same assets following the transfer of equity ownership
- the Target Company typically can continue to operate under its current licensing and regulatory arrangements (assuming no regulatory impact on that status as a result of the change of ownership)
- contractual relationships of the Target Company should continue unaffected after the transaction, unless those contracts contain consent requirements or change of control restrictions

The disadvantages of a stock acquisition include the following:

- because the Target Company continues in operation, the amount invested by the Buyer in the stock of the Target Company is at risk, since that investment may suffer as a result of claims against the Target Company relating to matters that arose prior to the acquisition, whether or not known at the time of the acquisition
- for United States income tax purposes, the assets of the Target Company retain their historic tax basis, so that the depreciation basis remains unchanged and typically is not “stepped up” to reflect the purchase price paid for the stock (absent certain special tax elections)

Advantages and disadvantages of the acquisition of membership interests in a limited liability company and partnership interests in a partnership are comparable to those listed above. However, because limited liability companies are taxed as partnerships in the United States (a different tax scheme than applicable to corporations), there is some additional tax flexibility in that context. For instance, it is possible to obtain an increase in the tax basis of the assets of the limited liability company or partnership, even though the assets themselves are not purchased directly by the Buyer. Those complex tax structuring issues are best addressed with United States tax counsel.

d. Asset Acquisitions

An alternative to the acquisition of the Target Company's stock is the acquisition of the Target Company's assets. In an asset acquisition, the selling party is the Target Company itself (unlike a stock acquisition, where the shareholders of the Target Company are the sellers). The acquisition documents will identify those assets to be acquired (both tangible and intangible) and often will contain schedules listing those assets in detail. Among the advantages of an asset acquisition are the following:

- the Buyer has the flexibility to pick the assets that it wants to purchase and the liabilities that it is willing to assume, by expressly identifying them in the acquisition agreement, with all other assets and liabilities generally remaining with the Target Company
- under the laws of most states, not all of the shareholders of the Target Company need to authorize the transaction (although authorization or prior notice may be advisable to avoid potential claims and disruption)
- because the actual assets are being acquired, the purchase price will be allocated to each particular asset, and that allocated amount will become the Buyer's tax basis for depreciating or amortizing those assets, for United States income tax purposes

The disadvantages of asset acquisitions include the following:

- if the Target Company is a "C" corporation, the shareholders of the Target Company may be subject to "double taxation" on the proceeds of the sale, since those proceeds must pass through the Target Company on the way to the shareholders (*i.e.*, a tax on the sale of the assets at the corporate level followed by a tax on the dividend or liquidating distribution by the Target Company to its shareholders)
- because the assets that constituted the business of the Target Company will now be titled in the Buyer and not the Target Company, the Buyer may have to obtain licensing and regulatory approvals and consents from third parties to the assignment of the contracts of the Target Company to the Buyer
- complications may arise in converting the work force of the Target Company to employment status with the Buyer
- if the Buyer purchases and continues to use the name of the Target Company, confusion may arise among third parties with respect to responsibility for obligations arising prior to the acquisition
- transfer of certain assets, such as real estate, may result in additional expenses, such as deed recording fees, which in some states can be expensive

The appropriate acquisition method will depend on the particular facts and circumstances. The Buyer should thoroughly discuss the alternatives with professional advisors early in the acquisition process.

e. Hart-Scott-Rodino Antitrust Clearance

The Hart-Scott-Rodino Antitrust Improvements Act (HSR Act) requires that the ultimate parent entity of each party to an acquisition submit a properly completed notification form (in addition to a filing fee ranging from \$45,000 to \$280,000 generally paid by the acquiring party), if their acquisition meets certain size and jurisdictional thresholds. The purposes of the HSR Act are (i) to permit the regulating federal agencies, the Federal Trade Commission (FTC) and Department of Justice (DOJ),

sufficient time to analyze the transaction and determine whether to challenge the transaction prior to its consummation, (ii) to assure that certain information and data concerning the proposed transaction and the participants' operations are provided to the FTC and DOJ and (iii) to provide a means for those agencies to obtain from the parties additional information "relevant to the proposed acquisition."

The HSR Act requires filings if certain thresholds are met, regardless of the participants' views as to whether the proposed transaction does or does not have antitrust implications. If (i) sufficient sales into the United States or assets in the United States are present, (ii) the value of the acquisition is at least \$65.2 million (this number was set in February 2009 and is adjusted annually based on changes in the United States gross national product) and (iii) the parties meet certain size thresholds, then a filing will normally be required. Analysis of the applicability of the HSR Act is complicated, since several exemptions may apply and results are dependent on whether the Target Company is a corporation, limited liability company or partnership and whether the acquisition is one of stock or assets.

If filings are required under the HSR Act, the subject parties must separately fill out a form. Depending on the nature of the acquisition, completion of the forms may take between 8 and 160 hours (according to the instructions). Once the forms have been filed with each of the FTC and the DOJ and the appropriate filing fee has been paid, a 30-day waiting period commences in which the FTC and the DOJ analyze the transaction. Upon request, the FTC or the DOJ may (but are not obligated to) grant early termination of the waiting period. Once the waiting period expires or is terminated, the parties may consummate the acquisition. In rare situations, the FTC or the DOJ may extend the waiting period and request further information from the parties for purposes of their antitrust analysis, and, if antitrust issues are implicated, seek an injunction stopping the transaction.

Experienced HSR counsel should be consulted in determining whether a filing is necessary and in making any filings. The civil penalty for failure to comply with the HSR Act is \$16,000 (subject to periodic adjustment) for each day of violation, which may be imposed on the Buyer, the Target Company and any of their responsible officers.

f. Committee on Foreign Investment in the United States (CFIUS)

In 1988, Congress passed the Exon-Florio amendment to the 1950 Defense Production Act empowering the President to investigate acquisitions of United States businesses by foreign persons and to prevent such acquisitions if they would adversely affect national security. An interagency committee, Committee on Foreign Investment in the United States (CFIUS), was then created to advise the President whether to suspend or prohibit a transaction or, if the transaction had already taken place, to seek to require the foreign person to divest the United States business. CFIUS is a Cabinet-level group chaired by the Secretary of the Treasury and includes the Secretaries of various other federal agencies as well as certain other executive positions. CFIUS can look into any merger, acquisition or takeover of a United States business by a foreign person, including a foreign corporation or a foreign government, that may affect national security. "National security" is not defined in the law or implementing regulations. This absence was done purposefully in order to permit broad interpretation and maximum flexibility.

In summary, the CFIUS process begins with a detailed notice/disclosure voluntarily made by a party or parties to a transaction involving the acquisition of an existing United States business. In the absence of a voluntary notice, CFIUS or one of its members may make one. Once notice is received, CFIUS has 30 days to conduct a review to decide if it will investigate. Ordinarily, CFIUS must investigate if the foreign person is itself a foreign government or is controlled by a foreign government. If CFIUS decides not to investigate, that ends its involvement, and the parties are informed, the transaction may proceed, and the transaction cannot thereafter be overturned.

If CFIUS decides to investigate, it has 45 days to do so. At the end of the 45 days, CFIUS makes a recommendation to the President. If the recommendation is not unanimous, CFIUS's report must set out the differing views and issues for decision. Often, either during the review stage or investigation stage,

significant concerns raised by CFIUS are resolved by a mitigation agreement worked out between CFIUS and the parties. In such cases, CFIUS recommends approval of the acquisition subject to the conditions of the mitigation agreement.

The President has 15 days to make a decision after receiving a CFIUS recommendation. If he or she finds credible evidence that the foreign person might take action that would impair national security, he may exercise his powers to suspend, prohibit or divest. Such action is not subject to judicial review. If the President decides not to act, the transaction may proceed and cannot thereafter be overturned. Once the President has reached a decision, he must communicate that decision and the reasons therefor to the Congress.

If no party files a voluntary notice, CFIUS normally has three years from the date of the transaction to file an agency notice or investigate the transaction. If CFIUS fails to initiate action during that time, the transaction will be held harmless. One exception to this three year rule is that the Chairman of CFIUS, after consultation with the other CFIUS members, may request an investigation. The hold harmless provisions of CFIUS also will not protect a transaction if false or misleading material information was submitted, or material information was omitted, by a party to the transaction under consideration.

In 2007, the CFIUS statute was amended to expand CFIUS jurisdiction beyond traditional national security concerns to include the acquisition of United States businesses that involve critical infrastructure. Critical infrastructure is considered to encompass systems and assets – such as the transportation, communication, financial, and energy sectors – so vital to the United States that their incapacitation or destruction would have a debilitating impact on national security. Another change to the statute requires automatic 45 day investigations of acquisitions of United States businesses by foreign governments unless certifications were signed by certain high level officials that no national security issue was raised by the acquisition.

In considering whether to file a notice with CFIUS, the parties to a foreign acquisition of a United States business should examine several key factors, including whether the foreign entity gains control of the United States business, whether that business involves national security or critical infrastructure, and whether the likely view of CFIUS concerning the possibility of adverse action by the foreign entity makes the protection of a CFIUS safe harbor advisable.

A key issue for any foreign investment that CFIUS considers is whether a foreign entity has acquired control of a United States business. “Control” in the CFIUS context does not require a 51% voting share majority, nor does it mean that control is being exercised, only that it could be exercised. Prior to 2007, CFIUS regulations suggested that as little as 10% equity ownership might constitute control (in any event, it has always been emphasized that the facts of each case were to be considered on their own and in the context of all the relevant circumstances). In commentary to the new regulations issued in 2008, it was suggested that under certain circumstances, as little as 9% ownership might constitute control. This is borne out in the regulations themselves. However, as before, a passive investment of 10% is not “control,” nor is a start up, or “greenfield” investment, a “United States business” within the meaning of the regulations. In considering questions of control, the structure and all the conditions of the foreign acquisition and joint investment entity will be key.

g. Reporting Requirements for Foreign Direct Investment

Under the International Investment and Trade In Services Survey Act, foreign companies acquiring 10% or more of the voting interest of certain United States business enterprises (and certain United States real estate) must report that acquisition and make periodic filings to the Bureau of Economic Analysis of the United States Department of Commerce (BEA). Reports required to be filed with the BEA include the following:

- Initial investment reports (Forms BE-13 and BE-13C Exemption Claim, and BE-14)
- Quarterly balance of payments reports (Forms BE-605 and BE-605 Bank)
- Annual reporting (Form BE-15)
- Five year interval reporting for benchmark surveys (Form BE-12)

Initial investment reports are required in conjunction with acquisitions resulting in ownership of (i) a 10% or more interest in a United States business enterprise that has total assets of more than \$3,000,000 or (ii) 200 or more acres of real estate located in the United States. The form requires disclosure of information about the financial and operating history of the United States business enterprise, investment incentives, the foreign investor and the amount invested. Form BE-13 must be filed no later than 45 days after the investment.

A quarterly balance of payments report must be filed on Forms BE-605, if at least 10% of a United States business enterprise is owned by a foreign company at any time during the quarter and either (i) total assets, (ii) gross operating revenues or (iii) annual net income of that enterprise exceeds \$30,000,000. That form contains information relating to direct financial transactions between the United States affiliate and its foreign parent and is required to be filed within 30 days after each calendar or fiscal quarter (except that the report for the fourth quarter may be filed 45 days after that quarter).

Form BE-15 is an annual report that must be filed by May 31 of each year, updating financial and operating data of United States affiliates. Form BE-12, the Benchmark Survey, is a comprehensive investment form filed at least once every five years.

Further information about these reporting requirements and penalties for violations can be found at the BEA's web site, <http://bea.doc.gov>. These reports generally are confidential and can be used by the federal government only for analytical and statistical purposes. The information generally cannot be used for purposes of taxation, investigation or regulation.

h. Other Governmental Restrictions or Regulations Impacting Foreign Acquisitions

There are a number of United States export control and other foreign policy and national security related regulations and administrative programs that, although not specifically providing for the review of foreign acquisitions in the United States, nonetheless can materially impact the feasibility or desirability of such an acquisition or the process for completing it. The following is a very brief overview of some of these regulations and administrative programs. In addition, depending on the industry and nature of the acquisition, other industry-specific regulatory considerations can also come into play.

(i) U.S. Export Controls - EAR and ITAR

The International Traffic in Arms Regulations (ITAR) require a license or other authorization for the export from the United States, and, in most cases, the transfer to foreign persons, of defense articles and related technology and defense services. In addition, United States persons, including businesses, that are involved in manufacturing or exporting items subject to ITAR must register with the Department of State. Any U.S.-origin item not subject to export controls under ITAR is controlled under the Export Administration Regulations (EAR) which are administered by the Department of Commerce and apply to commercial and dual use items. There is no registration requirement under EAR. Both regulations consider any disclosure of technical data subject to ITAR or EAR, even through visual inspection to a foreign person regardless of the location (including the United States) to constitute a deemed export of the technical data to the country of permanent residence/nationality of the person. Also, in some cases, the physical transfer of items subject to export controls to foreign persons in the United States can constitute a controlled export (and, in any case, if physical access to an article in the United States by a

foreign person would allow that person to glean controlled technical data relating to the article, such access can result in a deemed export of technology).

ITAR and EAR may be relevant to a proposed acquisition in the United States in a number of ways:

- To the extent that due diligence by the foreign investor requires access to controlled technology, export authorization may be required to conduct such due diligence.
- If the acquisition involves an ITAR-registered business, there are advance notification requirements (at least 60 days in advance of closing) in connection with ITAR registration requirements which can allow the Department of State to require approval for transfer of ITAR controlled items to the new owner (a requirement that has not been ordinarily exercised). In addition, new ownership could affect the nature and speed of export approvals that will be granted to the business, which could affect the value of the business being acquired.
- To the extent that existing licenses or approvals held by the business to be acquired must be transferred or amended as a result of the acquisition, a failure to effectively coordinate and time the transfers or amendments can result in a disruption of the business post-acquisition.
- To the extent that the business to be acquired has technology subject to export controls, access to the technology by, or any transfer of the technology to, the foreign owner or managers, including management post-acquisition, could require licenses or approvals that may not be granted. These licensing requirements can impact planned management arrangements and plans to integrate or facilitate joint activities between the acquired business and businesses of the buyer outside the United States.
- Compliance with export controls is a high priority of the United States government, which imposes significant penalties for compliance failures. The penalties and other consequences for compliance failures generally are considered to continue with the business that is acquired. Accordingly, it is critical to assess any possible compliance failures as part of the acquisition due diligence process.

(ii) *U.S. Trade Embargoes - OFAC Regulations*

The United States currently maintains comprehensive trade embargoes against a number of countries, individuals and entities for a variety of foreign policy and other reasons, such as anti-terrorism, drug and proliferation initiatives. The embargoes are principally administered by the Department of Treasury Office of Foreign Assets Control (OFAC). The countries subject to embargo type restrictions include Cuba, Iran, Sudan, Syria, North Korea and Burma/Myanmar. The individuals and entities subject to such restrictions are listed on OFAC's list of Specially Designated Nationals and Blocked Persons. These restrictions can be relevant to acquisitions by foreign persons in the United States in a number of ways. First, generally, the restrictions would bar any listed individual or entity from lawfully engaging in any investment activities in the United States, and any attempt by a United States business to engage in investment transactions with such an individual or entity would constitute a violation. Second, to the extent that the foreign person proposing to make an investment in the United States engages in trade outside the United States involving countries or persons subject to the embargo restrictions, although the investment may not result in those activities being barred, it is important for the foreign investor to evaluate any risks or compliance undertakings that may result from the investment.

(iii) *Government Contract/Security Clearances*

If the business to be acquired is involved in work for the United States government, various government procurement related issues may be raised. First, if the business is engaged in work requiring

a Department of Defense or other federal government security clearance, substantial requirements will be imposed for the business to retain the clearance. These requirements can even relate to the structure of the investment and involve arrangements to limit certain influences and management input by the foreign owner. Arrangements to maintain clearances must be resolved in advance of the acquisition or the business could be lost (and future business could be at risk). In addition, depending on how the new owners are viewed from a United States national security standpoint, the business's competitiveness in seeking government contracts post-acquisition could be affected. Accordingly, evaluating the potential impact of foreign ownership of that business is critical in assessing the value of the acquisition. Finally, legislative initiatives periodically seek to disqualify or put at a disadvantage United States businesses owned by foreign persons in competing for at least certain types of United States government contracts. Those initiatives often focus on ownership involving countries deemed to present a strategic risk for the United States, such as presently the People's Republic of China. These risks should also be evaluated for possible impacts on the valuation of the acquisition.

(iv) *Immigration Laws*

To the extent that the post-acquisition business plan for the acquired business includes the assignment of foreign nationals to the United States in management or other capacities, it is important to evaluate immigration/visa requirements that may apply. Doing so ensures that the plan is feasible and allows for coordination of arrangements for the necessary immigration law approvals in order to avoid unnecessary delays and disruptions in putting management plans in effect post-acquisition. Further, if the business to be acquired is, itself, foreign owned, then the continued status of any foreign nationals in the business after the acquisition will also need to be analyzed. Since 9/11, the United States visa processes have been somewhat less predictable in terms of both whether a visa will be issued in a particular case and the length of time for processing. For a further discussion of United States immigration laws, *see* Chapter 10, *Immigration Law*.

Chapter 13

United States Joint Ventures

a. Joint Venture Partners

As noted in Chapter 12, *United States Business Acquisitions*, when a foreign company acquires a business in the United States through one of the methods described in that Chapter, the foreign company typically acquires exclusive control of that acquisition target. However, many foreign companies find it advantageous, when entering United States markets, to do so through a joint venture with a company that complements the business strategy of the foreign company. While that joint venture partner could be another foreign company, typically United States domestic companies fill that role, bringing knowledge and experience in dealing with United States markets.

As discussed below, the operations of a joint venture can be complicated and will only be successful if the joint venture partners (i) have a clear understanding of the business objectives of the joint venture and (ii) have anticipated and dealt with potential problems and challenges at the inception of the joint venture. The most successful joint ventures are those in which the partners are committed to the business plan but are realistic in assessing the strengths and weaknesses of joint venture operations.

b. Appropriate Legal Entity

The term “joint venture” describes a joint undertaking by two or more participants who share in the risks and profits of the enterprise and who are accountable to each other for the joint venture’s operations. A joint venture might consist of a simple general partnership or it could be housed in a formal legal entity such as a corporation or a limited liability company. The important thing to note is that, if a “joint venture” is operated through a “general partnership” (as opposed to a corporation or limited liability company), then each of the general partners (the companies engaged in the joint venture) will be subject to claims of creditors of the joint venture, without limit. For that reason, many joint ventures are established through entities that limit by statute the liability of their owners, with general partnerships (or hybrid limited partnerships) being used only when the general partners themselves have limited assets or liability exposure. See Chapter 3, *Entity Selection*, for a discussion of alternative United States business entities.

Sometimes the term “joint venture” is used to describe mere cost sharing arrangements and supplier relationships. Such usage can be dangerous, as it may create an expectation by third parties that is beyond what is contemplated by the contracting parties. To avoid the possibility of creating a general partnership (and the obligations to third parties that go with it) when none is intended, the term “joint venture” should be avoided in these situations.

When considering entering into a joint venture, a foreign company must consider which entity form will be the most tax efficient for both the foreign company and its United States counterpart. As noted above, typical entity structures used for joint ventures in the United States are limited liability companies or corporations.

The limited liability company, a relatively new form of business entity in the United States, can be used very effectively for joint ventures of all types. The reason is that a limited liability company, for United States tax purposes, is taxed just like a general partnership (rather than as a corporation). Consequently, all tax attributes, including profits and losses, flow through to the owners, as opposed to being taxed at the entity level (as is the case with a corporation). However, unlike a general partnership, a limited liability company provides liability insulation to its owners (as a corporation does). Limited liability companies are very efficient, from a tax standpoint, for both the United States joint venture

participants as well as for the United States subsidiaries of a foreign company. They provide a great deal of flexibility when structuring ownership arrangements, profit distributions and the ultimate disposition of the joint venture business.

In some circumstances, joint ventures between a United States subsidiary of a foreign company and a United States company are housed in a separate United States corporation. While this structure is not as tax efficient as use of a limited liability company, the corporate form may be more appropriate under certain circumstances.

In addition to determining the most advantageous entity for a joint venture, the foreign company must also decide how the interest in that entity will be held. The alternatives include (i) direct ownership by the foreign company (typically not advisable), (ii) ownership by a special purpose United States corporation which is wholly-owned by the foreign company or (iii) ownership by a United States corporation acting as a holding company for the various interests of the foreign company in the United States. While a foreign company usually does not want to directly hold an ownership interest in a United States limited liability company for the reasons set forth in Chapter 3, *Entity Selection*, and Chapter 6, *Taxation of United States Operations*, limited liability companies can be very effective entities for joint ventures between the United States subsidiary of a foreign company and a United States joint venture participant.

Some foreign companies find it advantageous to house all of their ownership interests in United States operations in a United States holding corporation. That holding corporation can own the interests in joint ventures directly or can do so through a separately created subsidiary entity of the holding corporation formed for that purpose. That subsidiary entity, in turn, could be a limited liability company or a corporation, since tax reporting for the holding corporation most likely will be consolidated for United States taxation purposes with its wholly-owned subsidiary entities.

c. Joint Venture Documentation

The documents establishing a joint venture will govern the relationship between the joint venture participants. If the joint venture is operated through a limited liability company, an “Operating Agreement” will outline the relationship among the owners (referred to as the “members”). The various items typically covered in an operating agreement are described in Chapter 5, *Limited Liability Company Formation and Operation*.

If a general partnership or limited partnership is to be used for the joint venture, the relationship among the owners (“partners”) and the organization and operation of the venture will be provided in a “partnership agreement.” The content of a partnership agreement is usually similar to that of an operating agreement.

If a corporation is the joint venture vehicle, the relationship among the owners (“stockholders” or “shareholders”) is described in a series of documents, including Articles of Incorporation, bylaws, shareholders agreements, resolutions of the Board of Directors and other documents referenced in Chapter 4, *Corporation Formation and Operation*.

Brief mention is made below of a few key areas that should be thoroughly addressed in joint venture documents. The last section of this Chapter briefly discusses exit strategies that should be built into a joint venture.

d. Required Capital

One of the most important matters to address at the inception of a joint venture is the capital that will be required from the joint venture participants to adequately fund joint venture operations. While an accurate projection of cash flow and capital requirements for the initial year of a joint venture is critical, it

is even more important that the joint venture participants clearly understand the expected commitment of funds over a longer period. Joint ventures sometimes fail as a result of misperceptions of the participants about the need for long-term financial commitment. It can be frustrating and financially devastating to determine halfway into the development of a joint venture business that there is a fundamental misunderstanding among the joint venture participants about the need for, and availability of, funding to carry out the purposes of the joint venture.

e. Management Processes

Another critical requirement of a successful joint venture is clear communication and authority lines. The management process should be thoroughly discussed and documented in the joint venture agreements, and mechanisms should be established to facilitate (and in some circumstances require) dialogue and interaction between the joint venture participants. Misunderstandings and difficult times can best be weathered if trust and understanding has developed between the joint venture participants. The joint venture document should be designed to foster that environment.

f. Exit Strategies

One of the more uncomfortable issues to deal with when forming a joint venture is how the joint venture ultimately will be dissolved and whether members will be permitted to exit if material circumstances change. Those events can be positive ones if the joint venture has achieved its objectives and has been profitable. On the other hand, it can be traumatic if the joint venture operations have been a disappointment to one or both of the participants.

Because it is not known at the outset what the future will hold for a joint venture, it would be unproductive to try to anticipate all possible outcomes and draft provisions in the joint venture documentation to deal with an unlimited range of possibilities. Certain events, however, should be discussed and addressed in the joint venture documentation, since there is some likelihood that they will arise. Those include (i) the unanticipated need of one of the joint venture participants to sell its interest in the joint venture, (ii) deadlock in the management of the joint venture, (iii) mechanisms for dealing with third party offers to acquire the joint venture and (iv) restrictions on the ability of one joint venture participant to unilaterally unwind the joint venture. Those and related matters are discussed, as well, in Chapter 5, *Limited Liability Company Formation and Operation*.

Chapter 14

Customs, Duty and Tariffs

a. Introduction

Customs laws are designed to serve various governmental policy objectives. Through restrictions on the importation of goods, customs laws promote revenue collection through tariffs, protection of the health and safety of citizens (e.g., to keep out “foot and mouth” disease) and enforcement of product specific protections, such as anti-dumping, quotas and country-of-origin certifications. The Department of Homeland Security (DHS) is charged with, among other things, administering and enforcing customs laws and regulations, which it does primarily through two agencies, United States Customs and Border Protection (CBP) and United States Customs and Immigration Enforcement (ICE).

Some goods can be exported to the United States relatively easily and free of restrictions. Other items, however, are subject to prohibitions, restrictions and quotas. International treaties such as NAFTA and GATT (discussed below) are integral parts of that regulatory system. With some exceptions, most imported goods will be subject to duty.

The United States importer (the importer of record) bears the responsibility for declaring the initial valuation, classification and rate of duty for goods entering the United States, all of which are subject to the review and approval of CBP. The relationship between the importer of record and CBP is one of “informed compliance.” CBP informs the international community of applicable rules and restrictions, and importers conduct their business accordingly. If an importer fails to voluntarily adhere to those rules, CBP will impose “enforced compliance.” An important aspect of this system is that the importer must exercise reasonable care in all of its importing activities, since failure to do so may result in detention or seizure of goods, as well as civil and criminal penalties.

b. Customs Laws and Procedures

Generally speaking, the steps for importation into the United States of goods exceeding \$2,000 in value consist of (i) entry, (ii) examination and (iii) liquidation, each of which is discussed below.

(i) Entry

When physical goods arrive at a port of entry, the owner, purchaser or a licensed customs broker must file entry documents with CBP in order to clear the goods through customs. In many cases, the importer will hire an agent or licensed customs broker to handle this function, which requires that the importer execute a power of attorney in favor of the customs broker.

In addition to filing the necessary documents, a bond must be posted with CBP to cover duty, taxes and fees likely to be incurred. An importer may obtain a bond through a United States surety company to cover a single transaction (single entry) or continuous transactions (annual). A high-volume importer should investigate the possibility of obtaining a continuous bond covering entries at all ports in the United States for a 12-month period.

The importer should be aware of certain mandated timeframes. If goods are not cleared through customs within 15 calendar days following arrival in the United States, they will be moved into general order storage, which can be expensive. The importer of record will be responsible for all storage costs. If the goods remain unclaimed after six months, they will be sold at auction.

(ii) *Examination*

The next step involves examination of the goods, the chief purposes of which is to determine (i) the value of the goods for customs purposes and their dutiable status, (ii) whether the goods are properly marked with the country of origin and have been correctly invoiced, (iii) if the shipment contains prohibited articles (*e.g.*, Cuban cigars) and (iv) whether the goods listed on the invoice match those actually shipped. Most shipments clear customs in a “paperless” manner because the data is electronically processed through the customs system.

Other United States federal agencies also may have an interest in the imported goods. Because CBP officials are located at each port of entry, they routinely enforce regulations on behalf of those other agencies. Examples of targeted goods include (i) food products, drugs and cosmetics (the Food and Drug Administration), (ii) agricultural commodities (the Agriculture Department), (iii) alcohol, tobacco and firearms (the Bureau of Alcohol, Tobacco and Firearms) and (iv) motor vehicles (the Department of Transportation and the Environmental Protection Agency).

Additionally, the Office of Foreign Assets Control (OFAC) administers sanctions and embargo programs that may prohibit imports from certain countries. A list and description of such programs can be found at OFAC’s website. For a further description of OFAC, *see* Chapter 12, *United States Business Acquisitions*.

(iii) *Liquidation*

If the entry documents are accepted by CBP as submitted by the importer without changes, the entry will be liquidated as entered. Liquidation is the point at which CBP’s ascertainment of the rate and amount of duty becomes final for most purposes. In the event that CBP determines that the entry cannot be liquidated as entered (*e.g.*, CBP contests the importer’s initial classification of the goods), then, if the rate of duty proposed by CBP is greater than the rate submitted by the importer, CBP will notify the importer and provide the importer with an opportunity to respond or, if the rate of duty proposed by CBP is more favorable to the importer, authorize a refund. If the importer does not respond to a notice of increased rate of duty, or CBP finds the importer’s response to be without merit, CBP will liquidate the entry as corrected and will bill the importer for the additional duty. If the importer is not satisfied with the duty rate decision of CBP, a protest may be filed.

The applicable duty rate will depend on whether the goods originated from a country on the “most favored nation” list of the United States and whether any treaties might apply. As noted below, for example, under the North American Free Trade Agreement (NAFTA), lower rates apply to certain goods that have originated within Mexico, Canada or the United States.

c. *Import Quotas and Tariffs*

Import quotas limit the quantity of certain types of goods that may be imported into a country during a particular period of time. Tariffs are monetary charges that attach to imported goods.

In the United States, import quotas are classified as either “absolute” or “tariff-rate.” Absolute quotas restrict the amount of a particular good that may be imported into the United States during a quota period and can be global or country-specific. Frequently, import quotas are filled soon after the quota period opens. Imports that arrive in the United States after the quota period has closed typically are warehoused or placed in a foreign trade zone until the next period opens. If the quantity of backlogged goods exceeds the quota when the next period opens, CBP releases goods on a pro rata basis.

Tariff-rate quotas do not restrict the amount of imports that may enter the United States during a given period of time. Instead, they restrict the number of goods that may enter the United States at a reduced duty rate during a quota period. Once the quota has been met, goods may continue to enter the

United States, but at a higher duty rate. An importer should consult with CBP about tariff-rate quotas, as they may not apply to all exporting countries.

d. Foreign Trade Zones

In the United States, foreign trade zones are customs-bonded areas located in or near ports of entry. These types of facilities sometimes are referred to as free-trade zones in other countries. Foreign trade zones are supervised by CBP, but for entry purposes, they are considered to be outside the territory of CBP. As a result, an importer can delay the entry step and the payment of duty by placing goods in a foreign trade zone. Although the zones are outside the jurisdiction of CBP for clearance purposes, operations within a foreign trade zone are subject to United States federal and state laws.

Goods delivered into a foreign trade zone may be stored, assembled, manufactured or processed. Duty will be payable only when goods exit the foreign trade zone for entry into United States commerce. The duty rate will depend on the original material and any finished goods incorporating that material.

e. North American Free Trade Agreement (NAFTA)

NAFTA establishes a free trade area between each of the United States, Canada and Mexico. The primary goals of NAFTA are to:

- eliminate tariffs completely on goods originating in NAFTA countries
- remove non-tariff barriers, such as import licenses
- increase investment opportunities
- provide protection and enforcement of intellectual property
- create effective administrative and resolution procedures

In order to qualify for preferential duty rates under NAFTA, a good must satisfy the NAFTA rules of origin. Under the rules of origin, transshipments generally will not qualify for NAFTA treatment. For example, goods made in Brazil but shipped through Mexico will not qualify for preferential NAFTA duty rates when imported into the United States. In certain circumstances, however, a non-originating good may qualify for NAFTA treatment.

Although NAFTA does facilitate commerce, it does not allow for the unchecked movement of goods. The United States, Canada and Mexico have many common customs procedures and regulations, but goods entering those countries must still comply with each country's laws and regulations.

f. General Agreement on Tariffs and Trade (GATT)

GATT was originally signed in 1947 to promote free trade among member nations by reducing tariffs and creating a common dispute resolution system. The goals of GATT include:

- non-discrimination amongst most-favored nations
- elimination of quantitative restrictions
- non-discriminatory administration of quantitative restrictions

In 1994, GATT was reformed after the Uruguay Round, and The World Trade Organization (WTO) was established in 1995 to oversee the administration of GATT, the General Agreement on Trade

in Services (GATS) and Trade-Related Aspects on Intellectual Property Rights (TRIPS). Today, the WTO is the primary international organization handling the rules of trade between member nations, which total more than 140 countries, accounting for 97% of world trade. Agreements that are signed by WTO members bind their respective governments to stated trade policies. As a member of the WTO, the United States is bound to uphold all of its WTO commitments to other WTO members, which include any agreements with respect to import tariffs, duty or other restrictions.

Chapter 15

Protection of Intellectual Property

a. Introduction

In many cases, the intellectual property of a foreign company constitutes some of its most valuable assets. Whether intellectual property is licensed or used by a foreign company in the United States, its protection should be a high priority. The procedures for protecting those assets in the United States are well established and can be quite effective, when properly observed.

Obtaining patent, trademark and copyright protection in the United States requires compliance with the laws of the United States as well as each other country that has, or may have, a connection to the intellectual property. Consequently, arrangements should be reviewed by intellectual property counsel in all countries involved.

b. United States Patent Protection

A patent in the United States is a grant by the federal government, issued pursuant to an application by the inventor that describes and claims an invention. The grant gives the patent holder the right to preclude others from making, using, offering for sale, selling and importing in the United States an invention that is covered by the patent. Although a United States patent can be used to prevent a competitor from importing, into the United States, products that incorporate or use the invention covered by the patent, it will not prevent a foreign competitor from using the invention in a foreign country and selling the product in other countries (unless protection has been obtained by the inventor in those other countries).

Correspondingly, even though a foreign company has obtained protection of its intellectual property under the laws of its home country, that protection does not extend to the United States. If a company is doing business, or has licensed intellectual property for use, in the United States, the protection obtained in foreign countries will be of little, if any, help in the United States. Additional steps must be taken in the United States in order to be assured of comparable protection.

Patent applications are filed in the United States Patent and Trademark Office (PTO). For an invention to be patentable in the United States, it must be all of the following:

- patentable subject matter
- useful
- novel
- non-obvious

To satisfy the first requirement, the invention must constitute either (i) a process, (ii) a machine, (iii) an article of manufacture, (iv) a composition of matter (v) a method of doing business or (vi) any improvement of the foregoing. A patentable invention also must have practical utility.

The third requirement is novelty (*e.g.*, the invention must be new). Reasons why an invention will not be considered novel include the following:

- it is already known or used by others in the United States
- it has been patented previously

- it has been described in a printed publication before the date of invention, or more than one year before the filing date of the application in the United States
- it has been abandoned
- it has been described in a patent application filed by another prior to the date of the invention

In practice, the novelty of an invention is determined by evaluating the knowledge in existence at the time the invention is devised. This body of knowledge is referred to as the “prior art.”

Finally, an invention must not be obvious. According to the applicable statute:

A patent may not be obtained... if the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains.

Among the factors considered in determining non-obviousness is the prior art itself, the differences between the invention sought to be patented and the prior art, and the level of ordinary skill in the art. Secondary considerations may also be considered in determining non-obviousness, such as commercial success of the invention, a showing that the invention addresses a recognized need, proof of the failure of others to produce the invention and unexpected results.

c. *Patent Process*

Evaluating whether to seek patent protection in the United States is time consuming and potentially expensive, because it requires an evaluation of prior art. However, it can be one of the most important steps that a foreign company can take in establishing operations in the United States.

A United States patent application must be filed in the name of the inventor. However, if the inventor is employed by a company under a properly drafted employment agreement, the inventor normally will be required to assign the patent application and the invention to the Company. The Company can record the assignment at the PTO to evidence its ownership. There is a continuing duty during the patent application review process to disclose to the PTO relevant information bearing on the patentability of the application, including other patents, patent applications, references and publications.

When granted, a United States patent typically has a life that extends 20 years from the effective date of filing of the patent application for utility patents. Additional time may be added to the term to account for administrative delays by the PTO in examining the application.

d. *International Patent Protection*

To fully protect patentable inventions, a foreign company must comply with the laws of each country where that invention might be used. While there are a number of similarities in the patent laws of the various countries, unique features seem to be the rule rather than the exception.

One of the most important differences between the patent law of the United States and that of other countries is that United States law provides patent protection for the initial “inventor” of a device or technology. Consequently, United States law contains elaborate mechanisms for determining who is the original inventor. Those that have merely copied or embellished on the invention are precluded from obtaining patent protection on the fundamental invention. In contrast, subject to the limited exception provided by the Paris Convention (discussed below), in many other countries, patent protection is

obtained by the party who first makes the filing, not necessarily the original inventor. The first to file party will be presumed to be entitled to patent protection in those countries.

Further, the patent laws of many foreign countries require that the invention be “worked” locally to keep the patent. United States patent law permits an inventor to maintain patent rights even if the inventor does not put it to “work,” provided that the required maintenance fees are paid.

Another important difference is that United States patent law preserves the right of an inventor to obtain patent protection for a period of one year from first disclosure, sale, offer for sale or commercial use of the invention. Subject, again, to the limited exception provided in the Paris Convention, patent protection is lost in many other countries unless a patent application is filed prior to *any* “commercialization” of the invention.

e. International Patent Treaties

Despite the discussion above, the world is not completely disorganized when it comes to patent protection. There are a number of treaties that attempt to bring some uniformity and fairness to the process. The United States and approximately 110 other countries are parties to the Patent Cooperation Treaty (PCT), which provides standardized procedures for filing patent applications in countries that are parties to the PCT. Most importantly, the PCT allows an inventor to use a single form for filing an initial patent application in multiple signatory countries. Subsequent national patent applications will still need to be filed in each of the countries designated in the PCT.

In addition to the PCT, the United States and approximately 160 other countries are parties to the Paris Convention for the Protection of Industrial Property (Paris Convention). The Paris Convention requires that each signatory country apply its patent and trademark laws to “foreigners” in an equal and uniform manner, relative to its own citizens. The Paris Convention, however, does not create any consistency or uniformity in the substantive laws of the signatory countries. A foreign company will simply have the same protections as would a local citizen in the United States.

The Paris Convention does provide the owner of a patent with a safe harbor filing period for subsequent applications in other signatory countries. Once an initial patent application is filed in a signatory country, the owner of the patent has one year from the date of the original filing in which to file a corresponding patent application in any other signatory country in which the owner seeks patent protection.

The United States is also party to bilateral treaties that permit “piggyback” filings of United States patent applications with treaty partner countries. Similar to the safe harbor filing period provided by the Paris Convention, applications with treaty partner countries must be filed within a specified time after the United States application is filed.

f. Trademarks and Service Marks

In the United States, a trademark can be any identifier which indicates the origin of goods and distinguishes them from the goods of others. Similarly, a service mark can be any identifier which indicates the origin of services and distinguishes them from the services of others. The identifiers may be, for example, words, names, phrases, logos, symbols, designs, images, and even sounds, smells, and colors.

In the United States, both trademark rights and service mark rights arise through the actual use of the mark in connection with a particular good or service. Registration is not necessary, although it is beneficial, because registration will confer certain presumptive rights and provide notice of the existence of the trademark or service mark. Under United States Trademark Law, certain generic, geographical,

surname and descriptive words cannot be registered, absent special circumstances. A trademark or service mark must be distinctive, relative to existing marks, in order to be registered.

A registration obtained in the United States will remain in force for a period of 10 years, provided that, between the fifth and sixth years, the registrant files an affidavit certifying that the mark has not been abandoned. The registration can be renewed continuously for additional 10 year periods, provided that the registrant has not abandoned the mark.

Trademark and service mark registrations, as with patents, must be obtained on a country-by-country basis, although the Paris Convention does provide comparable trademark filing protocols. However, there is a critical distinction in the Paris Convention. The safe harbor filing period for making subsequent trademark and service mark applications in other treaty countries is *six months*, rather than the one year period for patent applications.

A foreign company may be foreclosed from offering its products under its foreign trademarks in the United States, if pre-existing trademark rights are present in the United States. Consequently, if a foreign company contemplates selling a product under a particular trademark in the United States, it is advisable to conduct a search in the United States for any conflicting registered trademarks. It is also important to register a trademark in the United States early, to prevent competitors from selling a competing product under a confusingly similar trademark.

Foreign companies have an advantage over United States domestic companies in obtaining United States trademark registrations. Although a domestic company can file a so-called “intent-to-use” application before actually using the mark, a domestic company must prove actual use of the mark in the United States before obtaining a registration, while a qualifying foreign company, under the Paris Convention or the Inter-American Convention, may be able to obtain a United States registration without use in the United States, provided that the foreign company has filed an application or obtained a registration in any country that is a party to those treaties. However, unless the registered mark is ultimately used in the United States, it will not be possible to enforce those rights, and the registration may be subject to cancellation on the grounds of abandonment.

g. Copyright

In the United States, a copyright protects against copying published and unpublished original works of authorship or artistry (*e.g.*, literary, dramatic, musical and dance compositions, films, photographs, paintings, sculpture, other visual works of art and computer programs). Filings typically are not required in order to invoke protection under United States copyright laws. However, before an action for copyright infringement can be brought against an infringer, a federal copyright registration must be obtained for original works of authorship that are fixed in a tangible medium of expression. If copyright registration is obtained prior to the commencement of the infringement, the copyright owner may be entitled to additional damages.

The duration of a copyright varies. For works created by individual authors after January 1, 1978, the copyright remains in effect for the life of the author plus 70 years. For a joint work, the copyright will be effective for 70 years beyond the life of the last surviving author. With respect to a work for hire, an anonymous work or a pseudonymous work, the copyright will expire on the earlier of (i) 95 years from the year of first publication or (ii) 120 years after creation.

International treaties do provide some coordination of copyright laws. The United States and approximately 120 other countries are parties to the Berne Convention for the Protection of Literary and Artistic Works (Berne Convention). The Berne Convention provides that copyright work in one signatory country is entitled to automatic copyright protection under the laws of each other signatory country (without registration in those other countries) from the time that the work is originally created. Of course, the copyright protection is only as extensive as provided by the laws of those other countries.

h. Trade Secrets

In the United States, a trade secret is information that is not generally known or readily ascertainable, and that provides a business-related, competitive advantage to the owner of the trade secret. A trade secret can take the form of a formula, a pattern, a manufacturing process, a method of doing business or technical know-how. Trade secrets cover a wide spectrum of information, including chemical compounds, machine patterns and customer lists. The most critical feature of a trade secret is that it cannot be generally known to the public. Once it becomes known to the public, it is no longer entitled to trade secret protection. Trade secret protection will last as long as the trade secret stays a secret. One of the most famous examples of a trade secret is the formula for Coca-Cola.

In the United States, trade secrets are traditionally governed by state law (in many cases, modeled after the Uniform Trade Secrets Act). Trade secret laws vary from state to state, however, and not all states have adopted the Uniform Trade Secrets Act. The Economic Espionage Act of 1996 makes theft or misappropriation of certain trade secrets a federal crime.

i. Other International Conventions

Another international convention that attempts to inject uniformity into global intellectual property protection is the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs Agreement). The TRIPs Agreement was developed by the World Trade Organization (WTO) and applies to all of the WTO's members. The TRIPs Agreement is an attempt to bring a degree of consistency to protection of intellectual property rights. It addresses fundamental principles of intellectual property protection, enforcement and dispute settlement.

Any country seeking admission to the WTO is required to accede to the TRIPs Agreement, although underdeveloped countries may be able to phase in some of its requirements. Details of the TRIPs Agreement can be obtained from the WTO's web site at www.wto.org.

In addition, the United States and approximately 175 other countries are parties to the convention establishing the World Intellectual Property Organization (WIPO), a United Nations agency. The mandate of WIPO is to promote the protection of intellectual property worldwide. WIPO administers 21 treaties in the field of intellectual property. Further information concerning WIPO and those treaties can be obtained from WIPO's web site at www.wipo.int.

j. Licensing

The various costs of doing business directly in the United States may make it prohibitive for a foreign company, on its own, to profitably commercialize and exploit its intellectual property in the United States. A license of the intellectual property to a company already operating in the United States can generate royalties or other financial consideration, with little additional expense to the foreign company.

While licensing intellectual property for use in the United States may provide a quick and relatively easy income source, there are numerous potential pitfalls. A license necessarily will involve third parties and will lessen the owner's control over the intellectual property. For those reasons, it is important that any license be documented in a written agreement that clearly sets forth the rights and responsibilities of the licensor and the licensee. The following is a list of some of the issues that should be considered when negotiating a license agreement:

- What rights to the intellectual property will be granted to the licensee? Are the rights limited to selling products associated with the intellectual property or do

the rights include, for example, making and using a product? May the licensee grant a sublicense of the intellectual property to others?

- Will the foreign company be the owner of any improvements to the intellectual property made by the licensee, and will the licensee be entitled to a license to use the improvement?
- What territorial restrictions should be placed on the license? Keep in mind that territorial restrictions may create antitrust issues.
- Should the license be (i) exclusive, thereby preventing the foreign company and other licensees from also using the intellectual property in the specified territory or (ii) non-exclusive, permitting the foreign company and other licensees to use the intellectual property in the territory or grant the same license to others in the territory?
- What is the duration of the license and under what circumstances can the license be terminated prior to the end of its term? If the duration of a patent license exceeds the remaining duration of its patent protection, antitrust laws of the United States may be implicated.
- Is the licensee capable of protecting (and willing to protect) the intellectual property in the United States and in any country in which it will sell or provide associated goods or services? Being able to protect the intellectual property also assumes that the licensee can properly monitor whether the intellectual property is being stolen or misused.
- What marking and quality control requirements are needed? Often, the licensee must comply with the marking requirements of United States law by including ® for registered trademarks, U.S. Patent (#), etc. In addition, appropriate quality control provisions need to be included in a trademark license agreement to prevent abandonment of the licensed trademark.
- What warranties and indemnification rights will be provided to the licensee? The licensee will expect, at a minimum, a warranty that the foreign company has the authority to grant the license and an agreement by the foreign company to indemnify the licensee against claims of infringement.
- What confidentiality obligations are to be imposed? Will the foreign company or licensee receive information that it must treat as confidential?
- What consideration is to be paid for the license and when (or over what period of time) will it be paid? Royalties can be paid in many different ways, including in advance, at periodic intervals or contingent on profitability. Keep in mind that, if the stream of royalty payments is significant and an exclusive license is being granted, the license could be considered an asset acquisition requiring clearance by the Federal Trade Commission and Department of Justice under the Hart-Scott-Rodino Antitrust Improvements Act (*see* Chapter 12, *United States Business Acquisitions*).
- How can the foreign company enforce its rights against the licensee? Is injunctive relief available under applicable laws? What dispute resolution alternatives are most appropriate?

Chapter 16

Antitrust

a. Introduction

Free markets and private ownership are the hallmarks of the United States economic system. The purposes of antitrust laws are to preserve and protect the competition on which those concepts are based. In that regard, the United States Supreme Court has stated:

Antitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms.

Business operations in the United States are subject to numerous federal and state antitrust and trade regulation laws. The objective of those laws generally is to ensure that businesses can operate in a fair and competitive environment and that consumers can receive the benefits of a fair and free market.

If there is a single area of law in the United States that poses a danger to the uninformed, that area is likely antitrust law, making it essential that business managers operating in the United States have a general awareness of antitrust and trade regulation laws. Sanctions for violating antitrust laws in the United States are severe and can include fines and prison terms for individuals, fines for corporations, injunctive relief, governmental contract debarment, treble damages and attorneys' fees.

It should be noted that United States antitrust laws can impose sanctions based on foreign conduct that has a substantial anti-competitive effect in the United States. Companies operating abroad can be subject to United States antitrust liability if they have a presence in the United States or engage in conduct that produces some substantial adverse effect in the United States.

Globalization has increasingly subjected foreign companies to United States antitrust enforcement. In recent years, a substantial percentage of corporate defendants in criminal cases brought by the Antitrust Division of the Department of Justice were foreign-based, and a significant number of the individual defendants were foreign nationals. Recently, the Antitrust Division has successfully obtained convictions of foreign executives from, among other countries, the United Kingdom, Germany, the Netherlands, France, Italy, Norway, Japan, Taiwan and Korea for engaging in cartel activity, resulting in heavy fines and, in many cases, imprisonment.

b. Principal Statutes and Purposes

Antitrust laws preserve and protect free markets and private enterprise by assuring competition, preventing undue or unfair restraints on competitive activity and discouraging the formation of monopolies. The four principal federal antitrust statutes are (i) the Sherman Act, (ii) the Clayton Act, (iii) the Robinson-Patman Act and (iv) the Federal Trade Commission Act.

The Sherman Act prohibits agreements and understandings to unreasonably restrain trade in any product or service, including but not limited to cartel behavior. In addition, this statute prohibits illegal monopolization and attempts to monopolize.

The Clayton Act prohibits certain exclusive dealing arrangements in which the seller conditions the sale or lease of goods on the agreement by the buyer not to deal in the goods of a competing seller that substantially lessen competition, including certain "tying" arrangements. The Clayton Act also

prohibits stock or asset acquisitions that may substantially lessen competition in any relevant market. This provision is complemented by the provisions of the Hart-Scott-Rodino Antitrust Improvements Act, which requires that certain mergers and acquisition be reported to governmental agencies prior to closing (*see* Chapter 12, *United States Business Acquisitions*). In addition, the Clayton Act prohibits certain interlocking directorships between competing corporations.

The Robinson-Patman Act prohibits a seller, under certain circumstances, from discriminating in the price charged to competing purchasers or favoring one competing purchaser over another in the granting of promotional allowances and services. In addition, certain brokerage fees are not permitted, and buyer liability can be imposed in certain circumstances.

The Federal Trade Commission Act, although technically a trade regulation rather than an antitrust law, prohibits unfair methods of competition and unfair or deceptive trade acts or practices. As indicated by its title, this Act is enforced by the Federal Trade Commission.

In addition, there are numerous federal laws specifically concerned with unfair or anti-competitive practices by companies importing their products into the United States. For example, the Wilson Tariff Act of 1894 prohibits collusive conduct among persons importing goods into the United States resulting in restraint of trade. Anti-dumping statutes govern importation of goods into the United States at prices below which the foreign manufacturer sells such goods in its home market. Imports that are subsidized by a foreign government may be subject to so called “countervailing duties.”

Finally, many states have their own antitrust laws, which are often enforced by the state Attorneys General. These state laws often, but not always, parallel the prohibitions under the federal antitrust laws.

c. Sanctions and Remedies

Violation of the Sherman Act can result in criminal fines. The amount of the fines depends upon the volume of commerce affected, and corporate fines in excess of \$100 million are not unusual. Individuals, including corporate employees involved in the offending conduct, may not only be fined but imprisoned for up to ten years. In addition, private parties harmed by antitrust violations can sue the violator for three times the amount of their actual damages (“treble damages”) and recover attorney’s fees (even though in the United States, generally, each party pays its own attorney’s fees). Injunctive relief also can be granted, and violators can be debarred from bidding on government contracts. Intangible costs of these proceedings can also be substantial and include their invasive nature (permitted discovery will surprise those unfamiliar with United States litigation procedures) and the immense time and resources required to defend an antitrust claim.

d. Restraint of Trade

The Sherman Act, as interpreted by the courts, prohibits unreasonable restraints on trade that involve two or more separate actors. Reasonableness is assessed based on the adverse effect on competition (the “rule of reason”), although certain activities are considered so clearly unreasonable that they are deemed per se unlawful (unlawful without any detailed evaluation of the effect on competition). Under the rule of reason standard (but not under the per se rule), the market power of the entities whose activity is being considered plays an important role in determining the reasonableness of the restraint.

Activities that are considered per se unlawful include (i) price fixing, (ii) bid rigging, (iii) customer and market allocation, (iv) certain concerted refusals to deal, and (v) certain tying arrangements. Per se offenses involving two or more competitors are the most harshly prosecuted under the antitrust laws and can result in criminal liability.

(i) *Dealings with Competitors*

The greatest liability exposure under the antitrust laws stems from dealings with competitors. There are two primary reasons for this. First, the concept of an “agreement” under the Sherman Act is extremely broad. Some courts have even found that such arrangements can be evidenced by “a wink of the eye.” Second, direct evidence of an agreement is not required to establish a violation. Circumstantial evidence will suffice. Therefore, all contact with competitors, whether in a trade association or in a social setting, must be approached with some measure of caution, and any discussion of prices, costs, production plans or similar topics should be avoided.

(ii) *Dealings with Customers and Suppliers*

Most restraints involving customers and suppliers are judged under the rule of reason, and their legality will depend on whether or not they adversely affect competition. The following activities are not per se restraints of trade but, while not deemed automatic violations of the law, nevertheless may raise issues under the antitrust laws and, consequently, should be carefully reviewed:

- selective or limited distribution
- refusals to deal
- exclusive distributorships
- exclusive dealing arrangements
- full-line forcing
- certain tying arrangements
- territorial or customer restrictions
- non-compete agreements
- transshipping restrictions

Although agreements between suppliers and customers regarding the price at which the customers may resell the product were for many years considered per se violations of the Sherman Act, the United States Supreme Court recently re-interpreted the statute to hold such agreements between a supplier and its customers to be illegal only when the agreement in fact adversely affects consumers. However, a number of states’ antitrust laws continue to treat such vertical pricing agreements as unlawful per se, and vigorous efforts are underway in Congress to restore federal law to a rule of per se illegality.

e. *Monopolies*

The Sherman Act also prohibits monopolization, attempted monopolization and conspiracies to monopolize. Monopolization restrictions are concerned with the power of a firm with a dominant market share to raise prices or exclude competition, coupled with acts having the specific intent of gaining or maintaining such power. Obtaining a monopoly position by reasonable and fair competition (such as providing a better product or operating more efficiently) is not in itself unlawful. The offense of attempted monopolization requires a wrongful or predatory act for the purpose of obtaining a monopoly, with a “dangerous” probability of success.

f. *Mergers and Acquisitions*

The Clayton Act prohibits stock or asset acquisitions that may substantially lessen competition in any relevant market. The Antitrust Division of the Department of Justice and the Federal Trade Commission have jointly issued “Merger Guidelines” that set forth the basis upon which governmental

agencies will evaluate the legality of mergers and acquisitions under the antitrust laws. Advance notification to the Federal Trade Commission and the Antitrust Division of mergers and acquisitions may be required where the transaction meets certain threshold requirements of the Hart-Scott-Rodino Antitrust Improvements Act (*see* Chapter 12, *United States Business Acquisitions*).

g. Price Discrimination

While, under certain circumstances, price concessions to meet competition are allowed, the Robinson-Patman Act may prohibit a seller from giving a lower price to a customer that is in competition with another customer who is paying a higher price. That Act also (i) prohibits discrimination in promotional allowances and services, (ii) prohibits certain brokerage fees and (iii) imposes liability on purchasers who induce an unlawful price. The prohibition against price discrimination is subject to numerous defenses, and the issue of whether or not a price discrimination is actually unlawful is very fact specific.

h. State Laws

Most states have laws that are comparable to the federal statutes discussed in this Chapter, although (as noted above with respect to pricing agreements between a supplier and its customers) some deviations between federal and state antitrust laws do occur. The Attorney General for each state generally not only enforces that state's antitrust laws but may also pursue enforcement actions under the federal antitrust laws. State laws often permit competitors or customers who are injured by antitrust violations to recover damages as well. Sanctions for violation of state laws can be equally as onerous as those for violating federal laws.

Chapter 17

Owning and Leasing Facilities in the United States

a. Introduction

There are many laws in the United States that deal with the ownership and use of real property. Some of those laws have particular application to foreign companies (such as the Foreign Investment in Real Property Tax Act). That Act, and certain environmental and other laws, are discussed below.

b. Foreign Investment in Real Property Tax Act (FIRPTA)

FIRPTA is designed to assure that profit on the sale of real property situated in the United States and owned, directly or indirectly, by foreign individuals or entities is subject to income taxation in the United States. The theory is that the appreciation in the value of the property resulting in the profit is attributable to factors relating entirely to the United States. Consequently, when the property is sold, that profit should rightfully be taxed in the United States.

In order to track those profits, FIRPTA requires that the buyer of real property in the United States (with some exceptions) obtain from the seller of the property a certificate that the seller is not subject to FIRPTA. In the absence of obtaining that certificate, or in the event that a seller is subject to FIRPTA, the buyer is required to withhold a portion of the sales price and remit it to the federal government as a prepayment of the income tax attributable to the transaction.

For purposes of FIRPTA, a United States real property interest can consist not only of direct ownership of real property by a foreign national, but indirect ownership, as well. For instance, stock of any corporation that holds United States real property interests that amount to more than half of the value of that corporation can qualify as a United States real property interest. Real property interests also include instruments such as (i) options to acquire interests in United States real property and (ii) rights to share in the appreciation of United States real property ("equity kickers"). Interests in United States real property solely as a creditor, or pursuant to a security interest, typically are not considered United States real property interests.

c. Environmental Laws

Federal, state and local environmental laws must be evaluated in conjunction with the operation of any business in the United States. That is the case whether a foreign company owns real property outright or merely leases a facility. Environmental laws are applicable to owners as well as operators of facilities.

It is beyond the scope of this Guidebook to detail all applicable environmental laws, an exercise that would require volumes. The purpose here is to alert foreign companies to some of the issues and to provide examples for general familiarity.

There are dozens of federal, state and local statutes governing environmental matters. A very brief sampling of federal laws follows:

Environmental Law	Description
Comprehensive Environmental Response Compensation and Liability Act of 1980 (CERCLA or Superfund)	Imposes liability on owners and operators of a facility at which hazardous substances have been disposed, along with those who arranged for the disposal or transported hazardous substances to the facility.
Resource Conservation and Recovery Act (RCRA)	Regulates hazardous waste disposal, treatment and storage and underground storage tanks
Toxic Substances Control Act (TSCA)	Requires processors and manufacturers of chemical substances to maintain records of chemicals produced
Clean Water Act	Regulates discharges into waters of the United States, including wetlands
Clean Air Act	Establishes air quality standards and regulates emissions into the air from a variety of sources
Emergency Planning and Community Right To Know Act (EPCRA)	Requires certain facilities to provide information on chemical inventories to state and local emergency planners and responders and report releases of toxic chemicals to state and federal officials.

Application of environmental laws can be triggered by any number of business activities, a sampling of which include the following:

- moving earth in wetlands areas or with resulting water sedimentation
- emitting, discharging or releasing substances into the air or water
- generating hazardous waste
- treating, storing or accepting hazardous waste for disposal
- transporting hazardous materials
- owning or operating underground storage tanks or pollution control devices
- spilling oil or hazardous substances
- owning or operating a facility in critical watershed areas or in the habitat of endangered species

Since environmental laws can present significant exposure to a business, their application to a particular business should be thoroughly evaluated. International businesses should keep in mind the following basic principles when dealing in this area:

- **Environmental laws are very complicated**, consisting of layers of laws, regulations, policies and guidelines at federal, state and local levels.
- **Environmental laws are not fair**, liability being imposed in some cases regardless of whether a business was the active cause of the pollution or contamination.
- **Take environmental laws seriously**, since criminal sanctions or substantial civil penalties can be imposed for their violation.

- **Cheaper is not always better**, money invested in quality assistance pays off since environmental issues are complex and can have significant adverse affects if not properly resolved.
- **Compliance is smart**, since dealing with matters promptly and definitively is the best alternative. Companies are obligated to know the laws and comply with them. Ignoring them can lead to significant costs, disruptions and potential criminal sanctions.

d. Local Zoning and Land Use Regulation

Foreign companies also should be aware that regulation of the use of real property in the United States is very localized. Each community typically has its own zoning and land use regulations that apply to business use of property in those jurisdictions. Whenever evaluating a potential site for a facility, a foreign company should obtain assurance that its proposed use of the property meets all of the local and state requirements and that permits for occupancy and use of the facility can be obtained in the ordinary course. Experienced real estate advisors and attorneys can be of significant assistance in avoiding false starts in facility procurement.

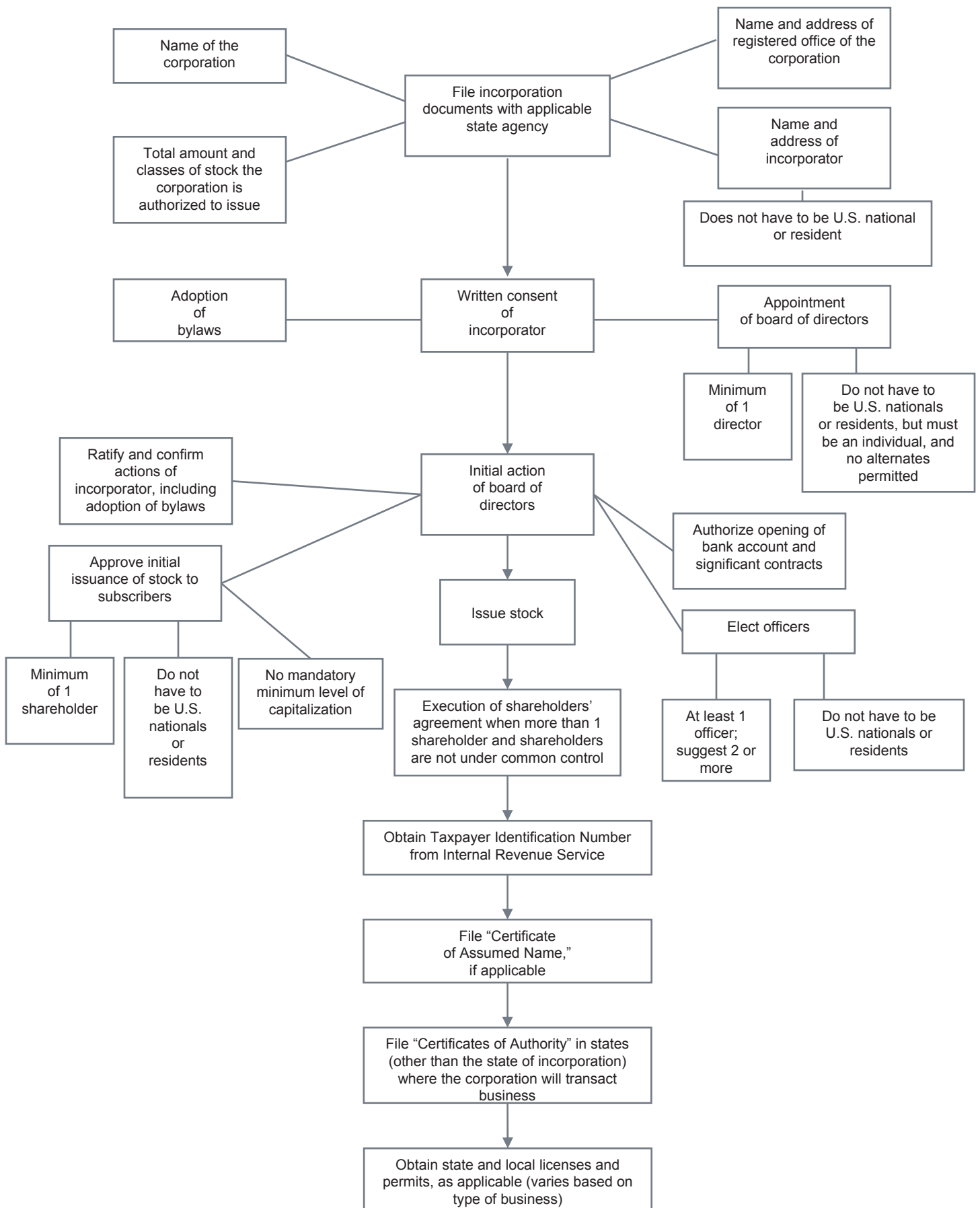
**Parties to the Convention on Contracts for the
International Sale of Goods**

Albania	Gabon	Netherlands
Argentina	Georgia	New Zealand
Armenia	Germany	Norway
Australia	Ghana	Paraguay
Austria	Greece	Peru
Belarus	Guinea	Poland
Belgium	Honduras	Republic of Korea
Bosnia-Herzegovina	Hungary	Romania
Bulgaria	Iceland	Russian Federation
Burundi	Iraq	Saint Vincent and the Grenadines
Canada	Israel	Serbia
Chile	Italy	Singapore
China (PRC)	Japan	Slovakia
Colombia	Kyrgyzstan	Slovenia
Croatia	Latvia	Spain
Cuba	Lebanon	Sweden
Cyprus	Lesotho	Switzerland
Czech Republic	Liberia	Syrian Arab Republic
Denmark	Lithuania	The former Yugoslav Republic of Macedonia
Ecuador	Luxembourg	Uganda
Egypt	Mauritania	Ukraine
El Salvador	Mexico	United States of America
Estonia	Moldova	Uruguay
Finland	Mongolia	Uzbekistan
France	Montenegro	Venezuela (Bolivarian Republic of)
		Zambia

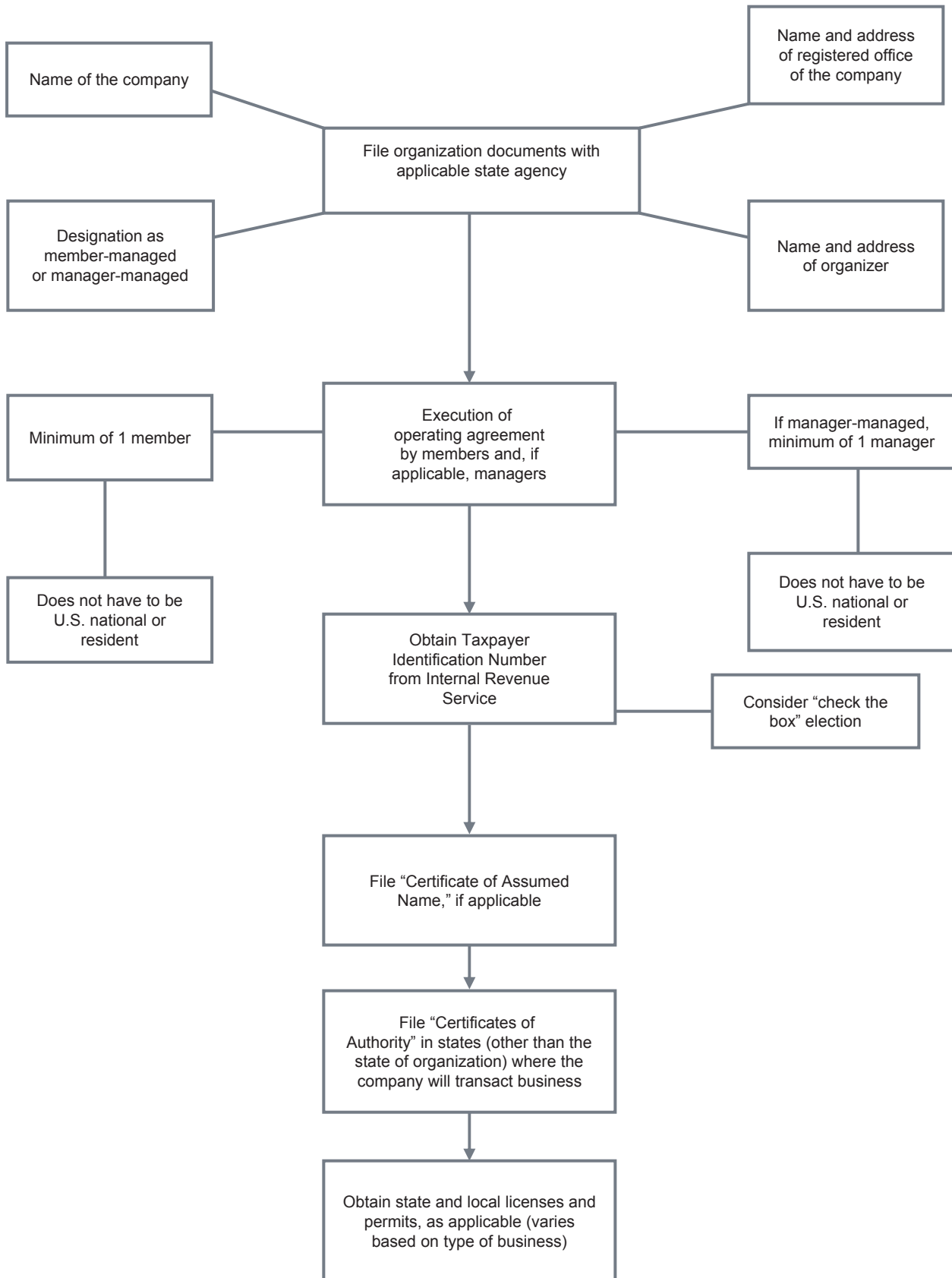
Parties to the New York Convention

Afghanistan	Ghana	Norway
Albania	Greece	Oman
Algeria	Guatemala	Pakistan
Antigua and Barbuda	Guinea	Panama
Argentina	Haiti	Paraguay
Armenia	Holy See	Peru
Australia	Honduras	Philippines
Austria	Hungary	Poland
Azerbaijan	Iceland	Portugal
Bahamas	India	Qatar
Bahrain	Indonesia	Republic of Korea
Bangladesh	Iran	Romania
Barbados	Ireland	Russian Federation
Belarus	Israel	Rwanda
Belgium	Italy	Saint Vincent and the Grenadines
Benin	Jamaica	San Marino
Bolivia	Japan	Saudi Arabia
Bosnia and Herzegovina	Jordan	Senegal
Botswana	Kazakhstan	Serbia
Brazil	Kenya	Singapore
Brunei Darussalam	Kuwait	Slovakia
Bulgaria	Kyrgyzstan	Slovenia
Burkina Faso	Lao People's Democratic Republic	South Africa
Cambodia	Latvia	Spain
Cameroon	Lebanon	Sri Lanka
Canada	Lesotho	Sweden
Central African Republic	Liberia	Switzerland
Chile	Lithuania	Syrian Arab Republic
China	Luxembourg	Thailand
Colombia	Madagascar	The former Yugoslav Republic of Macedonia
Cook Islands	Malaysia	Trinidad and Tobago
Costa Rica	Mali	Tunisia
Côte d'Ivoire	Malta	Turkey
Croatia	Marshall Islands	Uganda
Cuba	Mauritania	Ukraine
Cyprus	Mauritius	United Arab Emirates
Czech Republic	Mexico	United Kingdom of Great Britain and Northern Ireland
Denmark	Moldova	United Republic of Tanzania
Djibouti	Monaco	United States of America
Dominica	Mongolia	Uruguay
Dominican Republic	Montenegro	Uzbekistan
Ecuador	Morocco	Venezuela
Egypt	Mozambique	Vietnam
El Salvador	Nepal	Zambia
Estonia	Netherlands	Zimbabwe
Finland	New Zealand	
France	Nicaragua	
Gabon	Niger	
Georgia	Nigeria	
Germany		

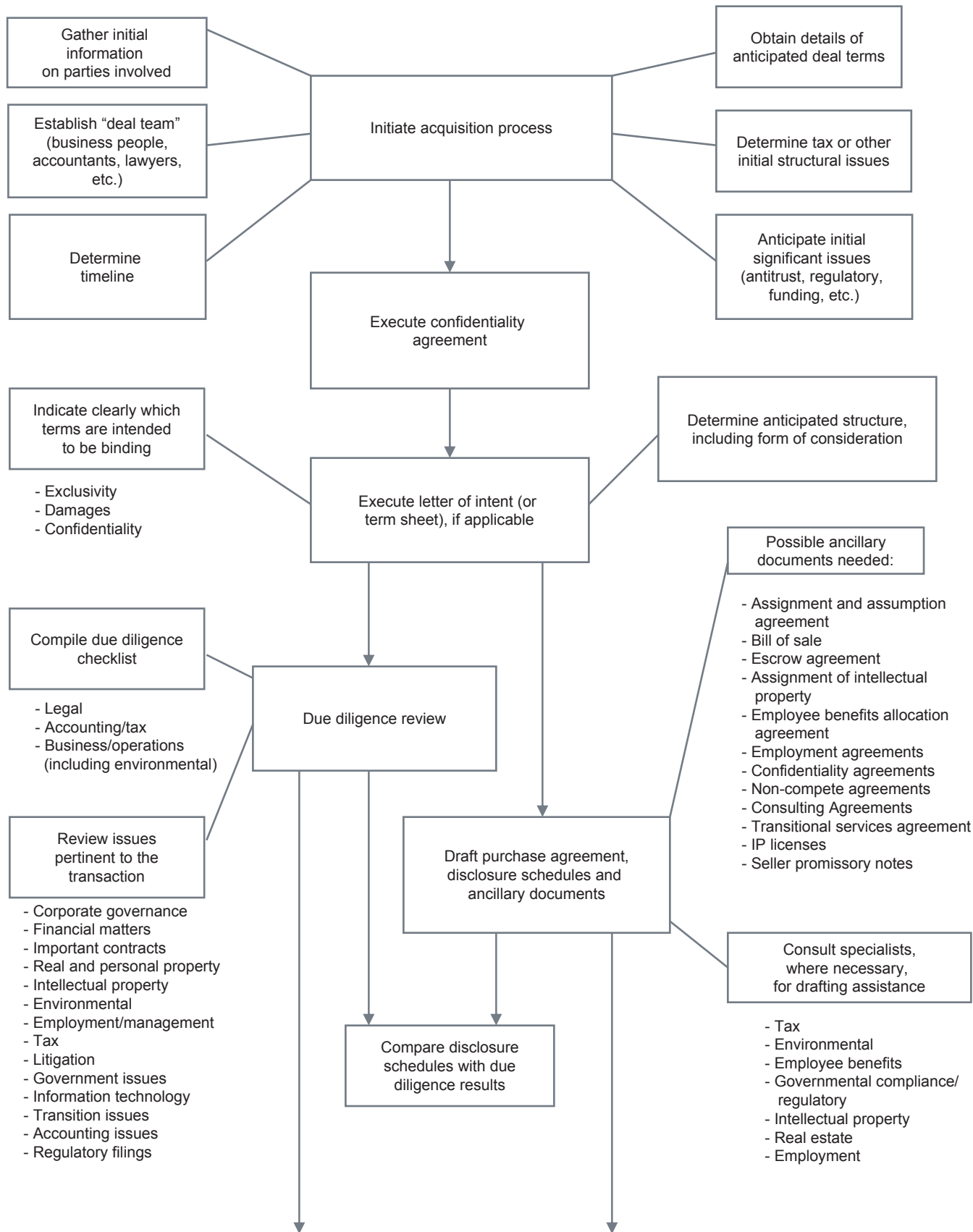
Corporate Formation Steps



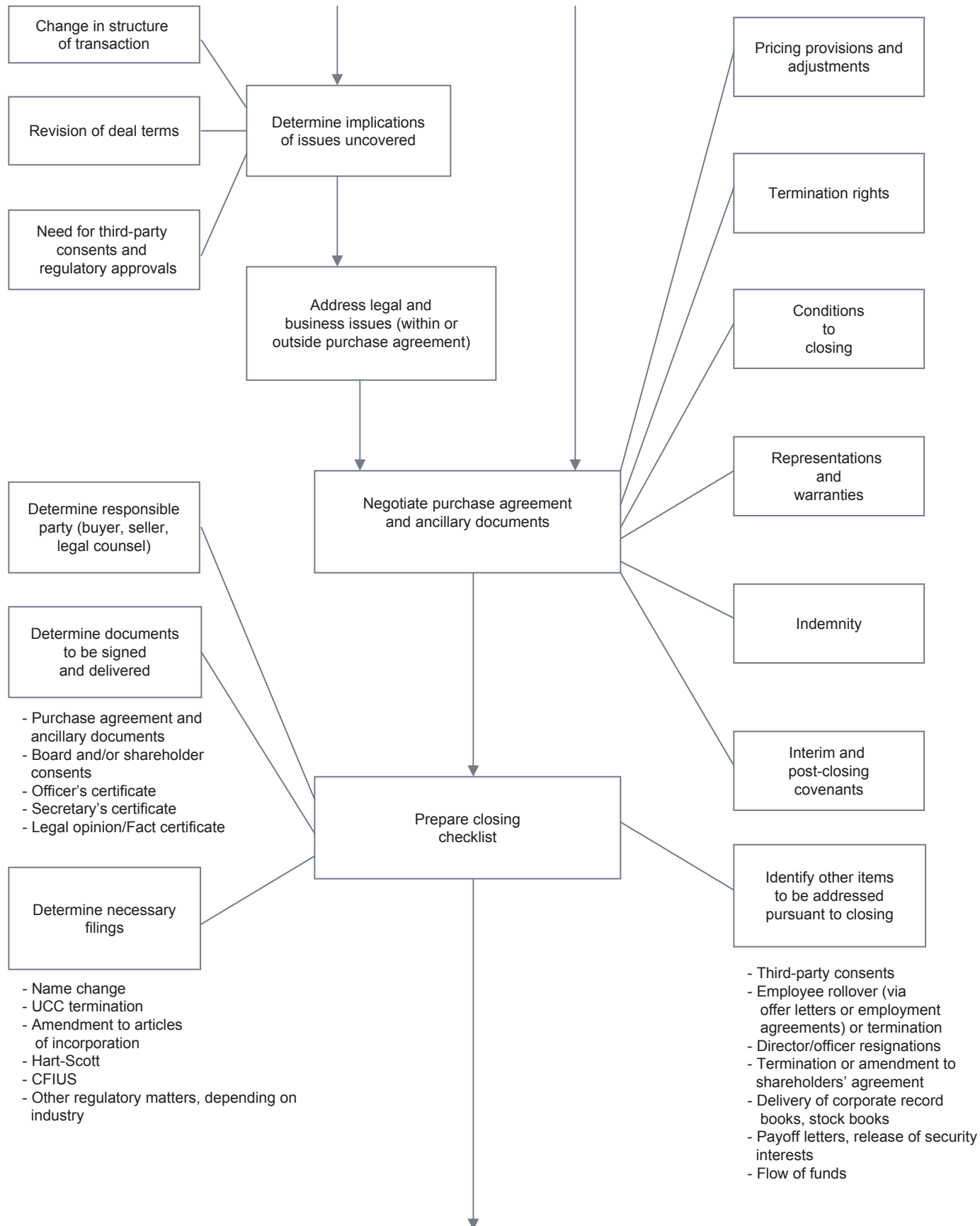
LLC Formation Steps



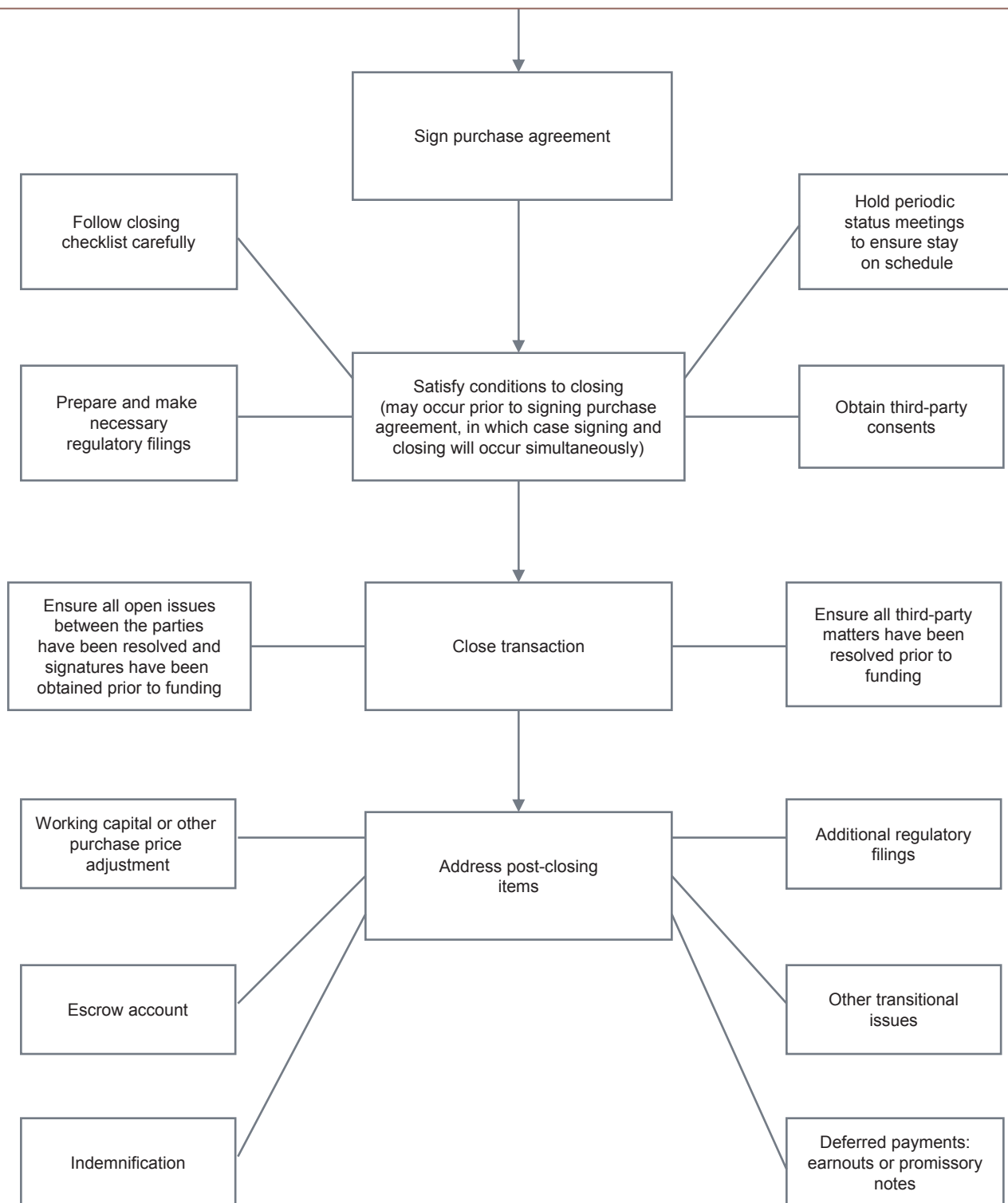
U.S. Business Acquisition Steps



U.S. Business Acquisition Steps



U.S. Business Acquisition Steps





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