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**A Swiss Principal Model Case Study:
Restructuring a Multinational Corporation to
Achieve Supply Chain and Tax Efficiencies
Through Territorial Optimization**

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The TO Project.

Three years ago, I was asked to serve as lead outside legal counsel to a U.S.-based public corporation in the biotechnology and life sciences sector with operations in thirty-five countries on all continents but Antarctica in the reorganization of its global corporate structure and operations. The object of the restructuring was to improve supply chain and tax efficiencies along regional lines in a project we will call here “territorial optimization,” or the “TO Project,” using the so-called “Swiss principal” model. Although other companies have adopted Swiss principal structures, projects as large as ours by U.S.-based companies have been comparatively rare, and the corporate, commercial, regulatory, operational and tax structuring requirements are complex. The heavily programmed and staged project is now nearing completion, and the techniques used and lessons learned should interest multinational enterprises interested in adopting a similar structure to improve efficiency and profitability.

In recent years, the Swiss principal model has gained attention from companies with multinational distribution and buy/sell operations in different countries, in part owing to Switzerland’s favorable tax rates and advance tax rulings, business-friendly environment, advanced body of commercial law that provides certainty in strategic planning, banking center status, low tax rates, central location in the heart of Europe (combined with independence from the European Union regulatory overlay and European monetary union), and federal cantonal structure.

In a Swiss principal structure, sometimes called a “commissionaire structure,” the corporate group’s local buy/sell companies, usually subsidiaries or unincorporated divisions, but theoretically also unaffiliated distributors, are replaced by one principal Switzerland-based company facing third party customers and vendors. It should be noted that a “principal” or “commssionaire” structure could be established in other jurisdictions than Switzerland that met some or all of Switzerland’s attributes; in fact, our project established not only a Swiss principal, but a U.S. principal to face the U.S. market and made provision for a future “Asian principal” for Asia-facing operations.

The corporation that decided to undertake the TO Project was a mature company in its core businesses, but was also engaged in a transition from an industrial manufacturing to a high technology enterprise in the life sciences sector. Like many other public companies with global operations and multi-billion dollar market capitalizations and revenues, the company had grown substantially without always optimizing its own corporate structure, although it had operated internationally for forty years. The company had grown through acquisitions over the years, caching its acquisitions in various places in the corporate structure that made sense at the time but which had grown unwieldy. For example, all procurement from upstream vendors was handled out of the United States, even when the vendors were in the EMEA (Europe-Middle East-Africa) region and their products, once shipped to the U.S., were combined into finished

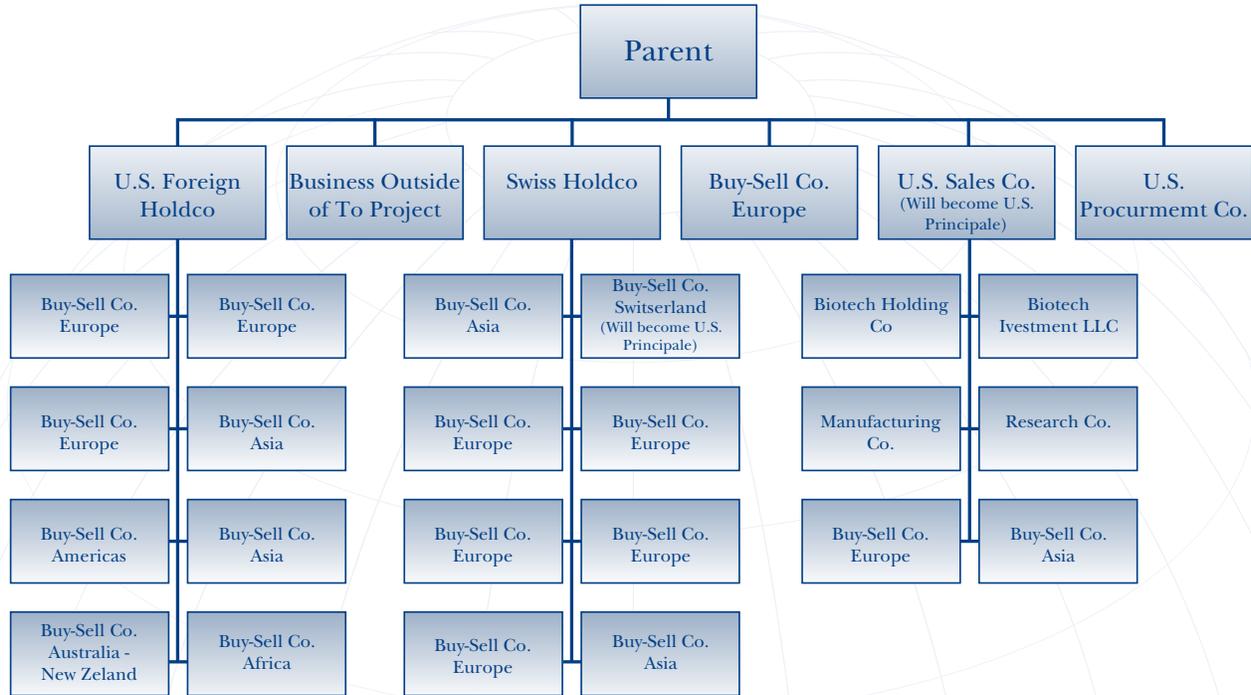
products to be sold back into the EMEA region.

The parent corporation (“Parent”), a Delaware corporation and the registrant under the Securities Exchange Act of 1934, had a set of direct subsidiaries under it, including a U.S. operating sales corporation that also held a number of operating subsidiaries, both domestic and foreign (“U.S. Sales Co.”); a U.S. corporation to handle procurement; a U.S. corporation that served as a holding company for non-U.S. operating subsidiaries (“U.S. Foreign Holdco”); and a Swiss corporation that held other non-U.S. holding and operating subsidiaries (“Swiss Holdco”). Some of the operating subsidiaries in a second, third or fourth tier below Parent had a second, minority shareholder in the corporate group as a result of local laws requiring at least two shareholders.

The TO Project’s ultimate task was to rationalize this structure through the creation of two holding company subsidiaries of Parent, one a direct subsidiary that would face the U.S. market (“U.S. Principal”), and the other an indirect subsidiary under Swiss Holdco, that would also be based in Switzerland and face the non-U.S. market (“Swiss Principal”). Both U.S. Principal and Swiss Principal would be converted from corporations taxed at the corporate level to the U.S. and Swiss equivalents of U.S. limited liability companies (“LLCs”), which, under Internal Revenue Code (“IRC”) “check-the-box” rules, would become disregarded entities not subject to U.S. taxation at their own level, but able to “pass through” their profits and losses to their owners in the same way as partnerships.

Figure 1

Simplified Diagram of Corporate Structure at Beginning of TO Project



Global buy-sell companies are scattered through corporate structure, subsidiary to U.S. Foreign Holdco, Swiss Holdco, U.S. Sales Co. and even Parent.

Under U.S. Principal and Swiss Principal would be the local operating companies, called “local territorial distributors,” or “LTDs.” To the extent the LTDs were already subsidiaries of Swiss Holdco, they would be contributed downstream to Swiss Principal. To the extent any LTDs were not subsidiaries of Swiss Holdco, they would have their shares contributed to Swiss Principal in a two-step process separated by months, from Parent, U.S. Principal or U.S. Foreign Holdco to Swiss Holdco, and then from Swiss Holdco down to Swiss Principal. In some cases, a three-

step process, first distributing the LTD up to U.S. Sales Co., U.S. Foreign Holdco or even Parent before contributing the LTD to Swiss Holdco and then down to Swiss Principal, was necessary because of where that operating company had been lodged in the pre-existing corporate group structure. The LTDs in each jurisdiction would also be converted to LLC equivalents under the local law under which each was formed, allowing them to be treated as pass-through entities for U.S. tax purposes.

The Team.

The TO Project was clearly the company's major pending strategic initiative, and it required buy-in and support at the company's highest levels. This buy-in required assessment of the business case for the restructuring, for example, the efficiencies in procurement, manufacturing and distribution cost, time and work flow to be gained by procuring locally from upstream vendors in the EMEA region products that were to be processed and resold in the same region by the insertion of Swiss Principal into the center of the process. A significant intra-company education effort was undertaken, explaining to local managers what the TO Project would mean for their operations, how it would improve efficiencies and profitability and streamline logistics for them.

A working group was assembled from internal resources, including a legal and tax sub-group, an information technologies group (a major reconfiguration of the company's enterprise-level supply chain software

was contemplated by the project, an aspect of the project that is outside the scope of this article), and systems, regulatory and compliance specialists). On the legal and tax team, the General Counsel and the Director of Tax and directors of international and domestic tax were key players. Also on the team were the controllers or managers of each local subsidiary, and local counsel in each jurisdiction in which the company operated. I was engaged as lead outside counsel to run the legal aspects of the project worldwide, reporting to the General Counsel, working in tandem with the Director of Tax and the international and domestic tax directors, interfacing with the local controllers, and supervising local counsel on six continents, which included engaging new local counsel where a pre-existing relationship did not exist or was thought to be unsuitable. Also on the legal and tax team were a team of outside international accountants and a team of consultants, responsible for the design of the supply chain and tax-efficiencies. Communication was obviously key in so complex a project and so large a team. A virtual “deal room” was set up, collaborative project management software was employed and weekly conference calls were scheduled.

Key customers and vendors were consulted early in the process, to assure them that the process would not affect the company’s relations with them and, in some cases, to obtain their prospective consent to the assignment of a contract to a new counter-party. Handled in this way, customer and vendor relations were rarely a sticking point.

The design of the TO Project was a highly creative process. The team created, and frequently revised, a large PowerPoint slide deck encompassing three years of staged legal transactions that diagrammed each step of the TO Project on a separate slide, showing each transaction's process and resulting structure. Care was taken to include in the restructuring only those companies involved in buy-sell operations on a regional basis, because they were the ones that would benefit from territorial optimization. Some companies involved in non-core businesses, for example, some research and development facilities, were not included. In addition, an intellectual property and regulatory review was undertaken for all included companies to make sure that any required assignment or modification of patents, trademarks or licenses, whether for manufacture, importation, exportation, or otherwise, were front-loaded so as to be in place or ready when needed further on in the project. In one or two cases, regulatory hurdles appeared sufficiently risky that the company involved was excluded from the TO Project, at least for the time being. In others, the intellectual property or regulatory issues, if not risky, appeared so time-consuming and/or expensive that the involved companies were excluded from the project for that reason.

Structuring U.S. Principal.

The first step in the project was to structure U.S. Principal. U.S. Sales Co. was chosen as the vehicle for U.S. Principal as it was already an

operating company that also held many of the assets that U.S. Principal was intended to hold. Before U.S. Principal could be formed, U.S. Sales Co. had to spin off some U.S. and non-U.S. subsidiaries.

These and most other operations in the TO Project were intended to be “tax-free” reorganizations under the IRC (the term “tax-free” is something of a misnomer compared to “tax-deferred;” the methods provided, when properly followed, allow the target company and its shareholders to avoid treating the acquisition consideration as income or capital. However, income or capital gain or loss is generally assessable when the stock received by the target and its shareholders in the acquisition is eventually sold.).

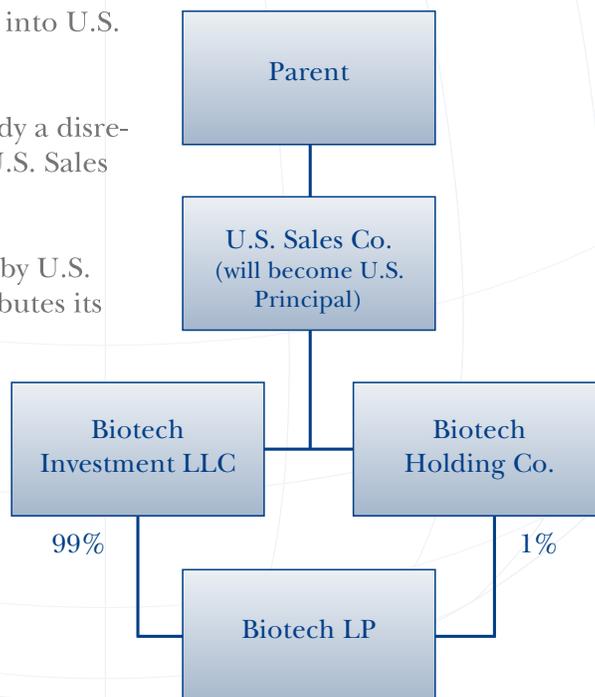
My first task was to distribute the equity of a few subsidiaries from U.S. Sales Co. up to it. One series of transactions is as illustrative. U.S. Sales Co., which was incorporated in a midwestern state, had a group of biotechnology-specialized companies under it, deriving from another acquisition. In the structure, U.S. Sales Co. held the equity of one limited liability company, called “Biotech Investment LLC” and one corporation called “Biotech Holding Co.” The two companies were formed in a second midwestern state. In turn, Biotech Investment LLC held 99%, and Biotech Holding Co. held 1%, of the partnership interests of a limited partnership (“Biotech LP”) that was formed in yet a third midwestern state, and which was the operating entity of the Biotech group.

In order to achieve a “tax-free” “liquidation” of the Biotech group under IRC §332, which allows the complete liquidation of subsidiaries without gain or loss being recognized (for Biotech Holding Co.) and §708, permitting termination of a partnership (for Biotech LP; Biotech Investment LLC was already a disregarded entity), a careful order of operations had to be followed. First, Biotech Holding Co. was liquidated and dissolved pursuant to a “plan of liquidation” as provided by §332; its 1% interest in Biotech LP was distributed to its parent, U.S. Sales Co. Second, the same operation was performed with Biotech Investment LLC; its 99% interest in Biotech LP was distributed to U.S. Sales Co.

Figure 2

Simplified Diagram of Biotech Group Transactions

- 1- Biotech Holding Co. liquidates into U.S. Sales Co. and is dissolved.
- 2- Biotech Investment LLC (already a disregarded entity) liquidates into U.S. Sales Co. and is dissolved.
- 3- Biotech LP, now wholly owned by U.S. Sales Co., terminates and distributes its assets to U.S. Sales Co.



At that point, U.S. Sales Co. held 100% of Biotech LP's partnership interests, meaning, that for purposes of §708, Biotech LP was no longer a partnership, since it had only one owner. Third, and finally, Biotech LP was dissolved and its assets distributed up to its parent, U.S. Sales Co. No taxable gain or loss on Biotech LP's dissolution and distribution of assets was realized by its partners, per IRC §731. These operations required coordination of all three midwestern states' company laws for mergers, dissolutions and windings-up, in one case of a corporation, in another of a limited liability company, and in another, of a limited partnership. As a practice pointer, we opted to conduct the three operations on three successive days, because not all the jurisdictions' secretaries of state offered time stamping as well as date stamping, and we wanted to leave no doubt that we had conducted the operations in the requisite order.

With the Biotech group and several other divestitures and group simplifications complete, our next step was to create a Delaware corporation ("U.S. Principal Delaware Mergerco"), wholly owned by Parent, into which U.S. Sales Co., incorporated in a state other than Delaware, would merge. To comply with IRC requirements, another "plan of liquidation" had to be drafted for U.S. Sales Co. Because U.S. Sales Co.'s state of incorporation's merger statute did not permit a short-form merger with a Delaware corporation, a full plan of merger had to be adopted. Once the certificate of merger in Delaware was issued, we converted U.S. Principal Delaware Mergerco to an LLC under the

Delaware corporate and limited liability company statutes, a two-day, two-step process resulting in U.S. Principal's creation in the form of a Delaware LLC, holding the assets of U.S. Sales Co. U.S. Principal was then renamed and an LLC operating agreement, directors and officers put in place. Finally, U.S.-facing subsidiaries under U.S. Principal were converted to LLC equivalents so as to be disregarded entities.

The series of operations to create U.S. Principal met the requirements of an "upstream C" reorganization under the IRC. Section 368(a)(1) of the IRC provides seven methods for structuring "tax-free" business combinations or divestitures. The forms are known by the letters, A - G, of the subsection pertaining to them. Generally, §368(a)(1) tax treatment is only available if the business combination provides a continuity of interest of the target's and purchaser's shareholders in the combined company, meaning in practice that at least a majority of the acquisition consideration must be in stock; a continuation post-acquisition of the target's business enterprise, and a valid business purpose to the transaction (not mere tax avoidance). Each subsection's special requirements must also be followed. The "C" reorganization is functionally an asset purchase; to qualify, the purchaser, using only its voting stock, must acquire "substantially all" of the target's assets. Purchaser can use an 80% or more directly owned subsidiary to acquire target's assets in exchange for purchaser voting stock. The "C" reorganization amounts to a de facto merger of target into purchaser or purchaser's subsidiary. Under §368(a)(1)(A), "tax-

free” reorganization treatment is also available for a statutory merger or consolidation under any state’s merger statute.

Creation of Swiss Principal.

Because Swiss Principal was to be a wholly owned subsidiary of Swiss Holdco, an existing Swiss Holdco subsidiary was selected for the role. The subsidiary’s assets were contributed to sister companies, it was renamed and converted to a “Gesellschaft mit beschränkter Haftung,” commonly abbreviated as “GmbH,” the Swiss/German equivalent of an LLC, so as to be a disregarded entity for U.S. tax purposes. With this step, both U.S. Principal and Swiss Principal were fully formed and organized. A new Swiss company was formed subsidiary to Swiss Principal to function as an LTD for the Swiss market.

Contribution and Conversion of non-U.S. Subsidiaries.

The heart of the project was the conveyance of the non-U.S. subsidiaries to Swiss Principal, in most cases in a two-step process, first to Swiss Holdco, then to Swiss Principal; and then the conversion of the LTDs into [for U.S. tax purposes] disregarded entities. These transactions were intended to qualify as IRC §368(a)(1)(C) triangular reorganizations. In almost all cases, the non-U.S. subsidiaries were held by U.S. Foreign Holdco; in a few others, by U.S. Principal; and in two cases, by Parent itself. A few non-U.S. subsidiaries were already held by Swiss Holdco;

only a late stage, one-step procedure would be necessary to contribute those subsidiaries down to Swiss Principal. The first step in the two-step process was therefore a share contribution by one of the U.S. companies (“Contributor”) to Swiss Holdco, a Swiss company (“Recipient”) of its shares in the non-U.S. subsidiary (“Target”) in exchange for shares of Recipient that would be authorized and issued to Contributor. A feature of Swiss corporate law prevented the authorization of shares before their issuance and required that only shares with a fair market value equal to their pro rata proportion to Swiss Holdco’s assets could be authorized and issued. Therefore, each contributed Target had to be valued within a short period in advance of the transaction to determine how many shares of Swiss Holdco (“Consideration Shares”) should be issued to Contributor in exchange for its contribution to Swiss Holdco of Target’s shares. Every time Recipient was to issue shares to Contributor, it had to conduct a “capital increase” reflecting the increase in its value occasioned by the contribution of Target’s shares. Because of the quasi in rem nature of company shares, in many cases, the share contributions had to be conducted under Target’s jurisdiction of domicile’s corporate law. Swiss law is agnostic on the choice of law, so, in the cases in which Target’s jurisdiction did not have to be the governing law, the U.S. law jurisdiction of Contributor was chosen.

In one instance, several direct subsidiaries of U.S. Foreign Holdco were contributed to one of their Asia-based sister subsidiaries in a

series of transactions. Two of these were conducted as triangular “C” reorganizations under IRC §368(a)(1); two others were conducted as “D” reorganizations, a rarely used format in which a corporation acquires “all or a part” of another corporation’s assets and, immediately following the transfer of assets, the transferor or one or more of its shareholders controls the transferee corporation. The Asian subsidiary issued Consideration Shares to U.S. Foreign Holdco in respect of the contribution of its fellow subsidiaries. The Asia subsidiary then was contributed to Swiss Holdco, its new subsidiaries becoming indirect subsidiaries of Swiss Holdco.

In addition to the U.S. tax considerations, legal and tax advisors in each of the subject jurisdictions were consulted to ensure that the transactions were “tax-free” from their point of view, as well. In two cases, contributions by Parent of directly held subsidiaries to Swiss Holdco were structured as IRC §368(a)(1)(B) reorganizations, in which a corporation acquires, solely for it or its parent’s voting stock, 80% or more of the target’s voting stock. The target becomes the purchaser’s subsidiary. As with all IRC §368(a)(1) transactions correctly executed, no taxable gain or loss is recognized on the transaction.

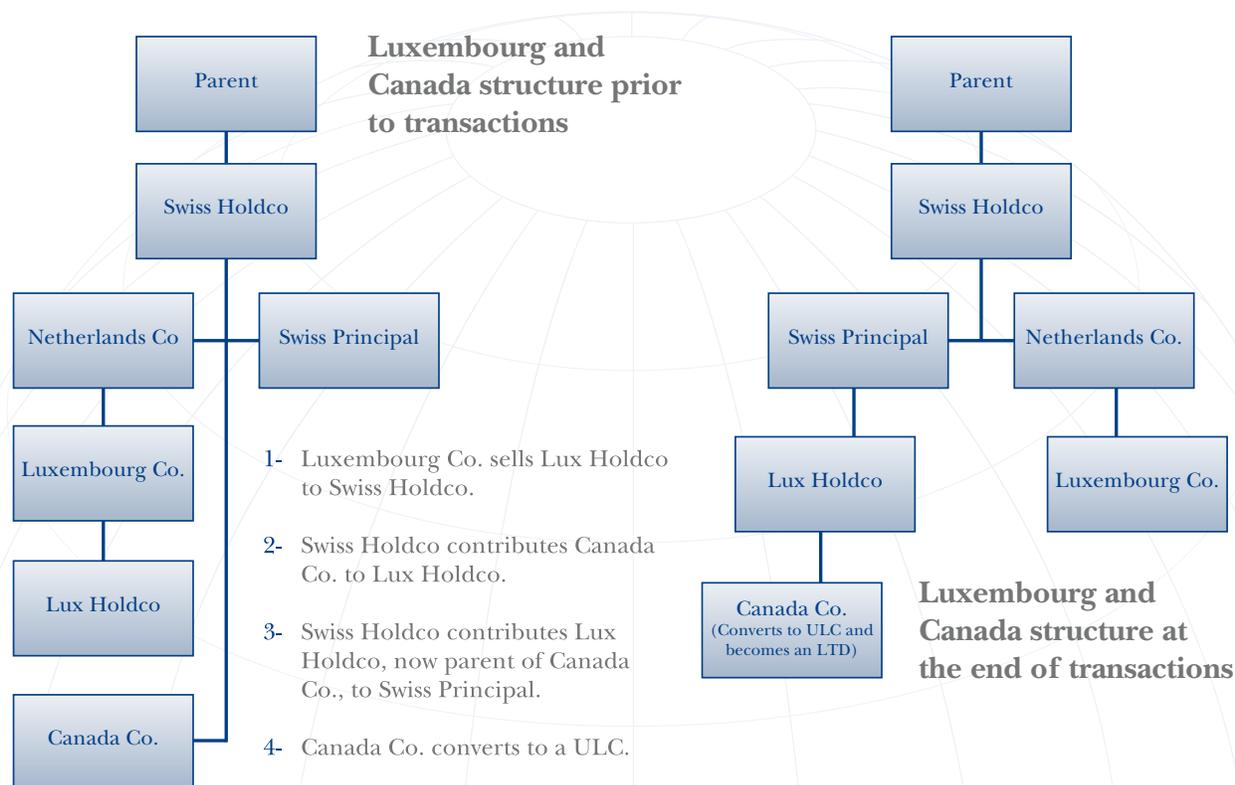
Since economies of scale on fees and other costs came into play on every Swiss capital increase and share issuance, there was a significant interest in coordinating and grouping the various Target share contributions into a few “waves,” so that each Swiss capital raise would be for several simultaneous contributions of Targets. We developed a short-form share

contribution agreement template, lacking many of the representations, warranties and covenants that would ordinarily be in a similar document. Nevertheless, the disparities between the different country corporate statutes, regulatory burdens and speed of processing documents at their respective commercial registries and analogous bodies made coordination of the efforts of local counsel and comptrollers difficult but critical. Finally, a major consideration was coordinating Target countries' stamp duty relief application procedures, in certain jurisdictions available for inter-company group transfers, which for one Target contribution represented a 1% stamp duty savings amounting to \$5,000,000.00. In some jurisdictions, the stamp duty relief application had to be made before the share contribution transaction (Singapore); in some countries after the transaction (U.K., Ireland), with official approval never on a precise schedule, further complicating the coordination of share contribution transactions for purposes of simultaneous Swiss capital raises and issuances of Consideration Shares. In China, an application for "Special Tax Treatment," or "STT," drove the timing of the transaction because of the different government offices through which the paperwork had to flow.

The second step of the Target contributions was simpler, being Swiss-Swiss transactions (Swiss Holdco as Contributor, Swiss Principal as Recipient). Swiss law itself does not require the issuance of Consideration Shares, so that in this stage of the TO Project, the issuance of Recipient Consideration Shares to Contributor, in this case, those of Swiss

Figure 3

Simplified Diagram of Luxembourg-Canada Transactions



Principal to Swiss Holdco, was mainly driven by the requirements of Target’s jurisdiction, which in some cases required the issuance and in others, not. We also conducted a share split of Swiss Principal, a tax-free reorganization for U.S. tax purposes under IRC §368(a)(1)(E), which permits recapitalizations in the form of stock-for-stock or debt-for-debt exchanges without recognition of taxable gain or loss, to facilitate use of Swiss Principal stock as Consideration Shares for some of the LTDs with comparatively lower valuations.

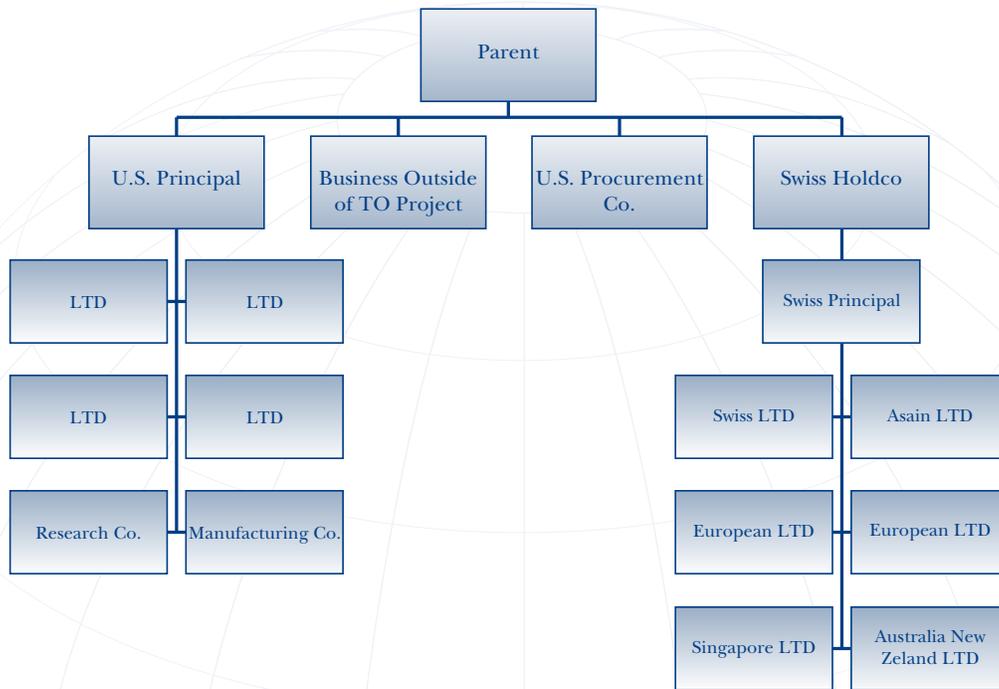
One case in this part of the TO Project was illustrative. In the case of the Canadian LTD, at this point held by Swiss Holdco, it was decided to convert the company, hitherto a corporation organized under the [federal] Canada Business Corporations Act, to a Nova Scotia unlimited liability company (“ULC”), because Nova Scotia ULCs, while holding out the possibility of unlimited liability in liquidation, as the name suggests, are eligible for check-the-box election as disregarded entities for U.S. tax purposes. However, there was concern at placing an unlimited liability entity directly below Swiss Principal and exposing Swiss Principal to contingent and future liabilities arising from the Canadian company. We developed a plan to use a Luxembourg company formed at an earlier point and earlier conception of the TO Project as a blocking entity. In a staged mini-group set of transactions, the Luxembourg company (“Lux Holdco”), which was the subsidiary of another Luxembourg company that was itself subsidiary to the group’s Netherlands subsidiary, itself due to become an LTD and to be dropped from Swiss Holdco to Swiss Principal, was contributed from the parent Luxembourg company to Swiss Holdco. Then, Swiss Holdco contributed the Canadian subsidiary to Lux Holdco in exchange for Lux Holdco Consideration Shares. Finally, Lux Holdco was contributed by Swiss Holdco to Swiss Principal, and the Canadian company converted from a Canada corporation to a Nova Scotia ULC, resulting in a chain of ownership from Parent-Swiss Holdco-Swiss Principal-Lux Holdco-Canada ULC. The only other use of the ULC

form, for similar reasons, was for the group's New Zealand subsidiary, which was held by the Australian subsidiary, which had been contributed by U.S. Foreign Holdco to Swiss Holdco.

Finally, the LTDs not already in LLC equivalent forms were converted to LLC equivalents in their local jurisdictions for U.S. "check-the-box" treatment as disregarded entities. Although the attributes of the LLC equivalents vary from jurisdiction to jurisdiction, and the conversion process itself varied from the simple to the byzantine, in each case it was ultimately possible to convert the LTD to a local law form that would be a disregarded entity for U.S. tax purposes. Again, it was necessary to consult local advisors to make sure that adverse local tax consequences could and would be avoided, and that the correct procedure was followed to ensure that the process was a true conversion, with no cessation of the LTD's existence. In several cases, it was necessary for the LTD to capitalize a loan with another member of the corporate group prior to converting. In several transactions, the requirements of local law required that the LTD, as converted to an LLC equivalent, maintain a second equity holder, making the goal of having each non-U.S. LTD wholly-owned by Swiss Principal impossible. In those cases, a minority equity position was given to another LTD (interestingly, in no case did the two-equity holder requirement prevent Swiss Principal from being the indirect owner of the minority stake. In other cases, local law required a certain level of capitalization for the LTD, and Swiss Holdco capitalized the company to the extent necessary.

Figure 4

Simplified Diagram of Corporate Structure at End of TO Project



At the end of TO Project, corporate structure is rationalized, with U.S.-facing LTDs subsidiary to U.S Principal and non-U.S. facing LTDs subsidiary to Swiss Principal.

We encountered a particular level of difficulty with the group's Argentinian subsidiary. Argentina requires registration by its commercial registrar of all non-Argentinian shareholders of Argentinian companies, and requires two shareholders. Our plan required the registration of both Swiss Principal and the group's Swedish subsidiary. This took a great deal of time, and because the two shareholders could not vote on anything pertaining to the Argentinian company until they were registered, it also delayed the conversion of the Argentinian company to the local LLC equivalent.

Mopping Up Procedures.

With the corporate restructuring largely complete, it remained to put in place several intercompany commercial arrangements that would allow sharing, consignment and distribution of inventory, use of warehouse space and other assets among U.S. Principal, Swiss Principal and LTDs in both the U.S. and non-U.S. markets. A feature of these commercial arrangements was to house all non-U.S. procured products in Swiss Principal, allowing conveyances by “flash title.” The main concern with these commercial arrangements was that they not do violence to the Swiss Principal model. These agreements therefore provided that Swiss Principal took title to procured goods and to company products to be sold into the non-U.S.-facing market, and that the LTDs did not at any time have title. Similar agreements were executed for U.S. Principal for the U.S.-facing market. Other features of the agreements existed because of the need to treat the intercompany agreements as arms’ length transactions.

Conclusion.

The buy/sell companies in multiple countries became LTDs of the Swiss Principal. The LTDs sell the group’s products in their own name, but on behalf of Swiss Principal, and at Swiss Principal’s risk. Title to the goods sold passes directly from Swiss Principal to the third party customer without vesting in the LTD in between. The Swiss Principal centralizes accounts receivable risk, currency risk, supply chain risk and inventory

risk and is able to coordinate the procurement and pricing of its suppliers. In doing so, it is able to spread, amortize and reduce those risks among all the regions covered by the LTDs. Swiss Principal also is able to set pricing across the group's distribution zones, reducing transfer pricing issues and enabling the realization of supply chain and tax efficiencies. However, the LTDs remain the contractual counterparties to the group's customers, able to operate locally, leverage customer contacts and local conditions and in general to focus on their core competency, sales. Also, the LTDs remain subject to most local regulatory constraints. U.S. Principal functions in the same way for the U.S.-facing market.

In most cases, implementation of the Swiss Principal model for a U.S. multinational corporation will require its corporate restructuring, including the setting up of a Swiss principal company and a U.S. principal to handle non-U.S. and U.S.-facing operations, respectively. It will be necessary to transfer the equity, by contribution or distribution, of LTDs, or create new LTDs, as the case may be, directly or indirectly subsidiary to Swiss principal and U.S. principal. It will be necessary to enter into intercompany commercial arrangements to ensure the tax ownership of inventory by Swiss principal and U.S. principal while allowing distribution and sharing of inventory by consignment or otherwise, distribution, management and ancillary services between Swiss principal, U.S. principal and LTDs, both in the non-U.S. and in the U.S.-facing markets. These commercial arrangements must be drafted in such a way as to satisfy U.S.,

Swiss and local tax authorities that the LTDs are economically independent and are not a “permanent establishment” of the Swiss principal, that the intercompany arrangements are at arms-length, and that the LTDs do not have the authority to bind Swiss principal in contract.

The company group expects to achieve supply chain and tax efficiencies savings of tens of millions of dollars per year, translatable to Parent’s share price and easily justifying its investment in the TO Project. Any U.S. corporation with multinational operations and an unoptimized corporate structure that would benefit from reorganization of its operations along regional lines and responsibilities should consider whether a Swiss principal or other commissionaire restructuring might achieve similar benefits for it.

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