K&L GATES

DOING BUSINESS IN THE UNITED STATES

A Guidebook for Non-U.S. Companies Operating in the United States

INTRODUCTION

Companies operating in the United States encounter numerous legal and regulatory issues arising from doing business in the world's largest economy. 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 non-U.S. companies commencing operations in the United States. It also can serve as a helpful checklist and monitoring device for companies already operating in the United States or considering expansion of those operations. Note that, while this 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.

The topics covered in this guidebook are not exhaustive and undoubtedly will prompt inquiries into other related issues. Our lawyers are experienced in dealing with inbound investments and operations of foreign companies in all states constituting the United States. K&L Gates has offices throughout the United States and 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
- Privacy and Cybersecurity
- Immigration
- Taxation
- Litigation
- Trade
- 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

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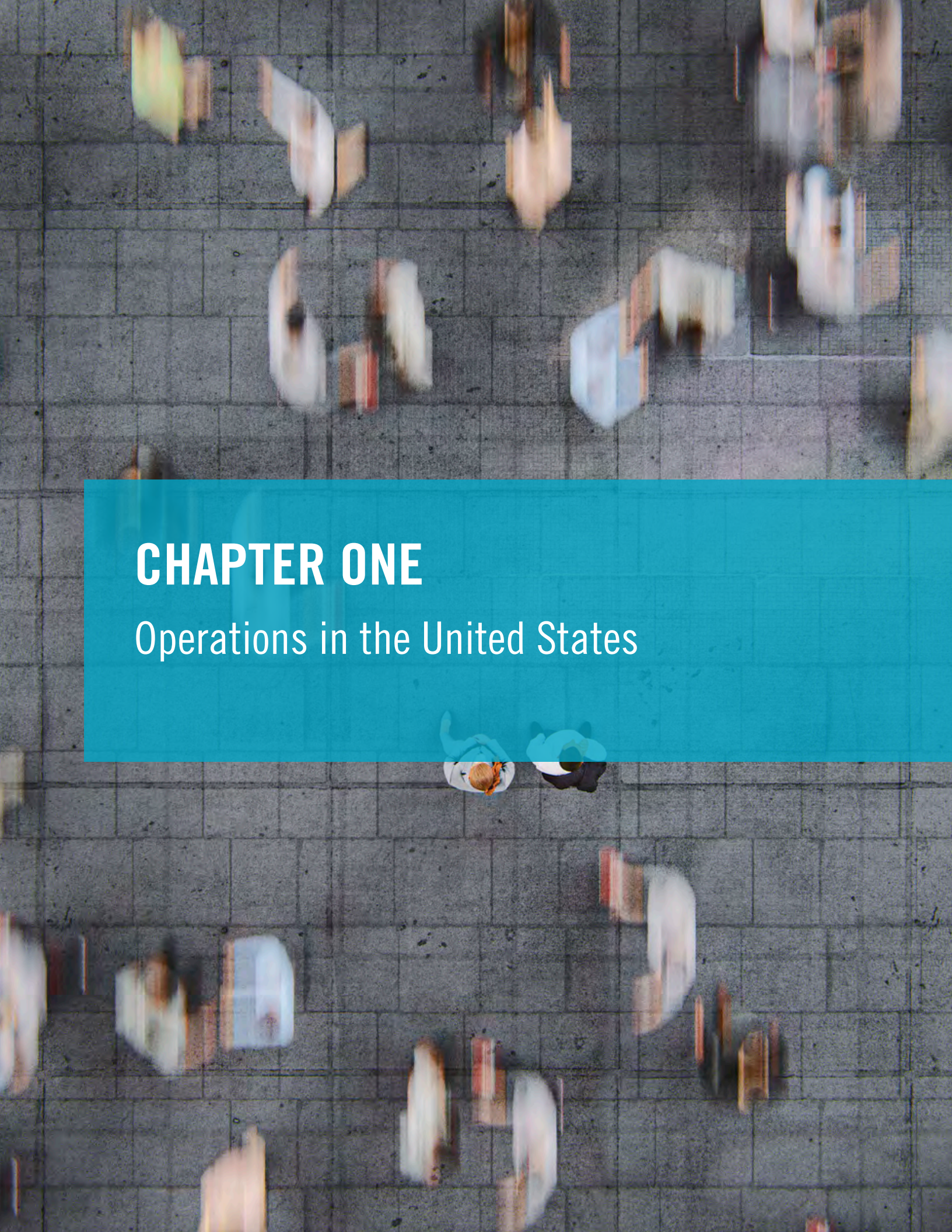


CHAPTER ONE

Operations in the United States

Chapter One

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 non-U.S. companies to U.S. markets with minimal impediment. While competition in the United States is healthy and spirited, U.S. businesses and business communities are receptive to non-U.S. companies entering U.S. 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 non-U.S. companies to these agencies and organizations can yield important information concerning various aspects of doing business in the United States. The U.S. Department of Commerce through its SelectUSA program is the primary federal agency involved in that effort. Contact information for SelectUSA is listed on its website at www.selectusa.gov/welcome.

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 U.S. operations of non-U.S. companies. Examples of those types of Economic Development Organizations include state departments of commerce, county offices of economic development, and various regional partnerships. Many of the first, second, and third tier cities in the United States have their own offices of economic development as well. An internet search of a region’s economic development efforts will yield a trove of useful information.

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

C. Relocation Incentives

Some state and local communities in the United States provide incentives for businesses that are relocating to, or significantly enhancing their presence in, those jurisdictions. In fact, the competition among the states and counties is so fierce that companies have the opportunity for significant cost savings dependent upon the scope of their U.S. project. Types of incentives vary greatly, but may take the form of (i) grants for training of local employees, (ii) funding for workforce education programs, (iii) enhancements of roads, infrastructure, or 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. Consequently, non-U.S. companies should explore possible incentives in detail prior to or in conjunction with their location selection process. Note that, once a company has publically announced a decision to locate in a specific community or state, or has entered into a binding property acquisition or building lease contract, the company's ability to initiate discussions or further negotiate incentives is greatly diminished and in some jurisdictions forfeited.

I. Background

In general, all state and local jurisdictions consider the following parameters (over a three- to five-year period) to determine the level of incentives to be provided by state and local authorities:

- Number of net new jobs;
- Wages/salaries of those positions on an individual location basis (not averaged across the entire workforce);
- Amount of capital investment (land, buildings, machinery and equipment); and
- Specific geographic location within the particular state and/or county.

Of course, other factors also play into the decision-making process, such as the industry or business sector, the impact on the region's existing supply chain, a "greenfield" construction of a new facility versus upfitting or occupying an existing facility, the unemployment level of the local community, the competitiveness of the project's location choices, etc. However, none of these factors is as influential as the key four parameters above.

Other "not-so-data-driven" items can also influence a government's decisions, including the number of recent economic development successes in the particular area, recently announced company closings, strength of a project company's brand, proximity to competitors, commitment to organized labor, and so forth.

The most important step in obtaining the right level of incentives is developing a structured internal process to approach and interact with economic development professionals that has a clear and concise outward narrative based on the company's project parameters. A few caveats to keep in mind are as follows:

- Incentives will never overcome a bad site location decision.
- Companies should pay close attention to the applicability of the offered incentives to their business model and their corporate tax structure.
- Companies should always analyze the balance of costs (taxes, labor, etc.) versus the stated value of the incentives.

II. General Site Selection / Incentive Process

The first step in the site selection process is an internal needs assessment by the company. The primary goal is to have a solid understanding of the project's parameters and what factors are integral to the company's decision-making process. Typical topics for consideration include labor requirements, proximity to key accounts or suppliers, facility specifications, time zone constraints, desire to lease or purchase an existing building or to engage in new construction, and industrial clusters. Once the needs

assessment is complete, the company can begin to eliminate certain geographic areas and focus on a smaller set of suitable target states or regions.

III. Initial Outreach

The company makes initial contact with states and/or geographic areas of interest, typically through a formal Request for Proposal (RFP). The RFP contains general information about the company, the project parameters, and the decision drivers. If the company uses a private sector economic development guide, such as K&L Gates LLP, the RFP is typically delivered under a project codename, as companies usually do not reveal their identity at this stage. Based on responses to the RFP, the company then further narrows the target list to specific communities and/or properties that meet their parameters.

IV. Company Visits

The company spends a few days on the ground visiting the narrowed list of sites and/or facilities (typically 24 hours in a specific community). These visits generally include, among other things, presentations on workforce, community resources, livability, infrastructure, and state and local incentives. At this stage, the company reveals its identity to the state and local officials.

V. Finalist Locations Selected (2–3 Locations)

After the site visits, the company again narrows its list to one leading candidate in two or three states or locations. At this stage, the incentive negotiations with local and state governments begin in earnest. Because of the long-term consequences of their ultimate decisions, the company may also wish to conduct second visits to finalist locations to gain a greater understanding of the local communities and their respective attributes.

VI. Final Site Selection

After additional negotiations, a winner is identified internally to the state and local government finalist. This stage is accompanied by submitting pertinent documentation and by drafting and reviewing incentives agreements between the company and the particular governmental entity. Depending on the jurisdiction and the public nature of the granting organization, there can be multiple steps in the formal approval process that may take up to several months. Finally, the company issues a joint press release with state and local officials announcing to the public its decision to locate in their community.

D. Types of Incentives

I. Traditional Incentives

At their core, state and local incentives can be divided into two primary categories: statutory and discretionary. Statutory incentives are those that have been delineated in state and local ordinances or statutes whose outcome and value are typically formulaic and require no negotiation, complex paperwork, or prior approvals by a governmental body. In most cases, the company simply completes and submits the appropriate form before the designated deadline once the stipulated job growth or investment levels have been achieved. Discretionary incentives, on the other hand, are those benefits that can only be obtained through negotiations with the state or local entities prior to locating in that particular area or before making a commitment to expand (in the case of companies with existing presence).

Although each jurisdiction has its own approach to incentives, and all are based on investment, job creation, and geography, some combination of the following are common:

- **Cash Grants**. Upfront incentives generally are used to offset the cost of infrastructure or other needed facility improvement.
- **Utility Rate Incentives**. Through long-term service agreements with the company, some utility providers offer per-unit price reductions on their service dependent upon the size and scope of the company's predicted usage.
- **Land/Building**. Depending upon the ownership of the property of interest, communities may be willing to offer either or both land and building at a reduced price.
- **Transportation Incentives**.
  - **Rail**. For companies that have a significant volume of inbound or outbound rail, Class I's and short line rail companies may offer incentives in the form of a per-car reduction in price or the installation of on-site rail related infrastructure.
  - **Port**. States with a port system often have incentives for using or increasing outbound or inbound cargo volumes.
- **Hiring and Training Assistance.** Many states offer customized training support through their local technical or community college systems. Often later referred to by companies as one of the most valuable incentives received, these services are typically provided at no cost to the company, but are regularly underappreciated during negotiations.
- **Tax Credits**. There are countless variations of state tax credit programs, most of which can be used to offset a company's annual corporate income tax. Credits are almost always statutorily prescribed and can be based on investment, job creation, or another easily identifiable measure. States generally limit the extent to which the credits can be used in a given year.
- **Property Tax Abatements/Reductions**. States that assess annual taxes on the value of land, building, and equipment often have incentive programs that enable eligible companies to reduce that tax burden. In some circumstances the reduction programs are statutory in nature and are generally limited to five years or less, while in other locations the principal terms are entirely negotiated between the governmental entity and the company, and the agreement can extend beyond 20 years.

II. Soft Incentives

Although traditional incentives similar to the ones referenced above are the most sought after form of governmental assistance, communities attempt to set themselves apart by offering "soft incentives" above and beyond the official "offer" or in lieu of a traditional program if a project is too small or does not meet the qualification criteria.

Some of those "soft incentives" include offering tailored human resource assessments and tutorials on interacting with an American workforce, local supply chain integration, as well as business networking opportunities for new and existing industry. Most jurisdictions have existing industry support teams who regularly check in on new companies to answer questions or provide assistance.

Because of the unique needs of international companies commencing their first operations in the United States, some state and local economic development offices have developed "Soft-Landing" or "Landing Pad" initiatives that serve as a business guide to the community. They help new companies connect with experienced service providers and support networks and direct them to state and local resources.

E. Legal Environment

The following description is quite general in nature but attempts to provide an overall framework of the U.S. 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 U.S. Constitution. Consequently, business operations in the United States must comply with state as well as federal requirements.

All companies 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 U.S. 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 (such as anti-discrimination laws), as well as various common law principles (such as liabilities for intentional infliction of emotional distress).

I. Statutory Law

A number of legislative bodies in the United States 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 U.S. Constitution. Federal statutes are limited by the U.S. Constitution to matters of broad applicability. In those permitted areas, legislation of 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 governed by federal legislation. It is of paramount importance to the U.S. 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 within the United States, 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, almost without exception, not formed under federal law. Those entities are products of state law, with each state having its own set of laws governing the formation and operation of business entities within that state. Companies often consider forming their business entities in Delaware because of that state's long and developed history of corporation statutes, as well as its court systems' experience with and efficiency in deciding matters of business law.

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 (EPA), which is a federal agency that implements and enforces laws enacted by the U.S. 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 within the sphere 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 courts in the federal system are the U.S. District Courts. Appeals from decisions of those courts are made to regional U.S. Courts of Appeal, with ultimate appeal to the U.S. Supreme Court. Note that the U.S. Supreme Court does not have to accept an appeal and most appeals to it, in fact, are not accepted. There are also several specialty courts in the federal system designed to deal with specific types of cases (e.g., the U.S. 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. 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. Note that not all states use the same nomenclature to specify their three levels of jurisdiction. In New York State, for example, the highest court in the system is known as the Court of Appeals, and the intermediary appellate courts are called the Appellate Divisions of the Supreme Court.

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.

V. Arbitration and Litigation

Dispute resolution procedures in the United States may be unfamiliar to a non-U.S. 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. Considerable planning 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 lawyer.

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 favoring alternative dispute resolution procedures (mediation and arbitration). Those processes are described more fully in Chapter 10, *Supplier and Customer Contracts*. Before full-scale litigation is permitted to proceed, many states require that parties participate in mediation efforts to determine whether common ground for settlement can be found.

F. Cultural Differences

The business environment in the United States likely will differ significantly from that in a non-U.S. 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, 2021 being abbreviated 1/5/21) to those with great import (e.g., the interactions between an employer and employee). A non-U.S. 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 non-U.S. 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. Non-U.S. 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. U.S. 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.

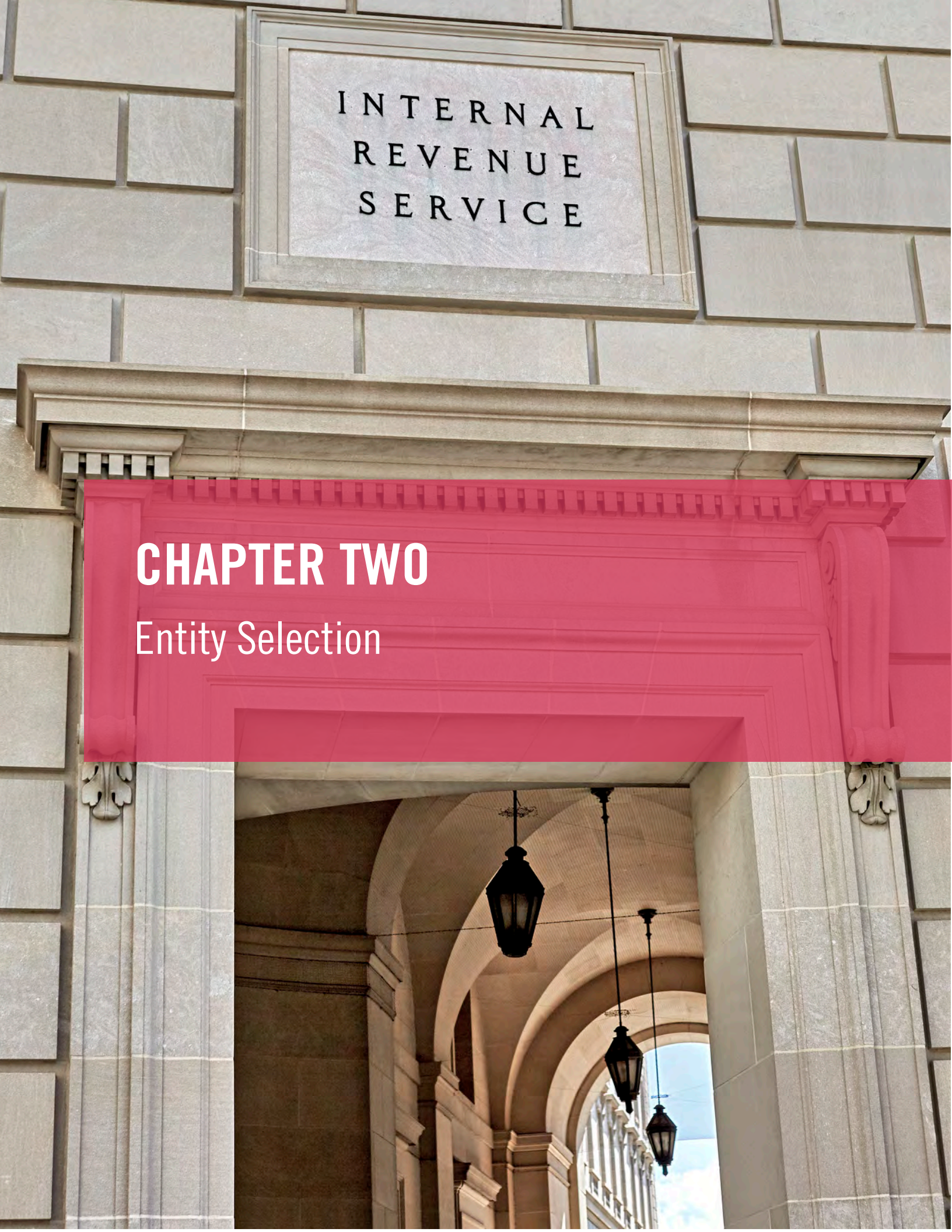
II. Community Involvement

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. Local HR Director

One of the most important decisions a company will make when establishing an operation in the United States is hiring or bringing in the right leadership team to lead the new endeavor. A key component of that initial success is finding the right human resources director. The ideal candidate is someone who has sufficient experience in the geographic region or in the particular business sector in the United States. The precarious balance between integrating company culture into the new facility, and embracing and adjusting to U.S. and regional customs, is one of the most complicated aspects of establishing a

presence in a new country. What motivates employees or improves production output in the home country may have the opposite effect or be illegal in the United States. For example, unlike curriculum vitae used in most parts of the world, American resumes are typically one page in length and do not include photos. Moreover, employers cannot ask potential employees about their age, pregnancy status, marital status, or how many children they have at home. Additional employment law topics are touched on in Chapter 8, *Employment Law (Federal and State*). A good human resources director can guide the company through the start-up process and serve as a cultural translator.



CHAPTER TWO

Entity Selection

Chapter Two

ENTITY SELECTION

One of the most important decisions to be made by a non-U.S. company establishing business operations in the United States is determining 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 3, *Corporation Formation and Operation*; Chapter 4, *Limited Liability Company Formation and Operation*; Chapter 5, *Taxation of United States Operations*; and Chapter 12, *United States Joint Ventures*.

A. Branches and Divisions

If a non-U.S. 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 company. Consequently, there is no intervening entity between the company and third parties dealing with its U.S. operations. Because of the potential liability exposure and significant tax complexities encountered when operating through a U.S. branch or division, many non-U.S. companies avoid direct operations in the United States, absent special circumstances (*see* Chapter 5, *Taxation of United States Operations*). If a non-U.S. 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 U.S. **subsidiary** corporation is a separate legal entity, owned (wholly or partially) by the 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 U.S. subsidiary maintain its independent status, because insulation of the non-U.S. parent company from liability to creditors of the subsidiary is dependent on that status.

Although it may be owned by a non-U.S. company, a U.S. 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 U.S. 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 parent company. Those rules and related issues are discussed in Chapter 5, *Taxation of United States Operations.*

C. Partnerships

If a non-U.S. 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 a non-U.S. 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 and general 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 U.S. business landscape, limited liability companies are a more recent entrant, having evolved during the past three decades. 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 5, *Taxation of United States Operations*, general partnerships, limited 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 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 and a limited partnership are liable, without limit, for activities of the partnership. On the other hand, limited liability companies provide the same liability protection for their owners (members) as do corporations for their stockholders (and as do limited partnerships for their limited partners).

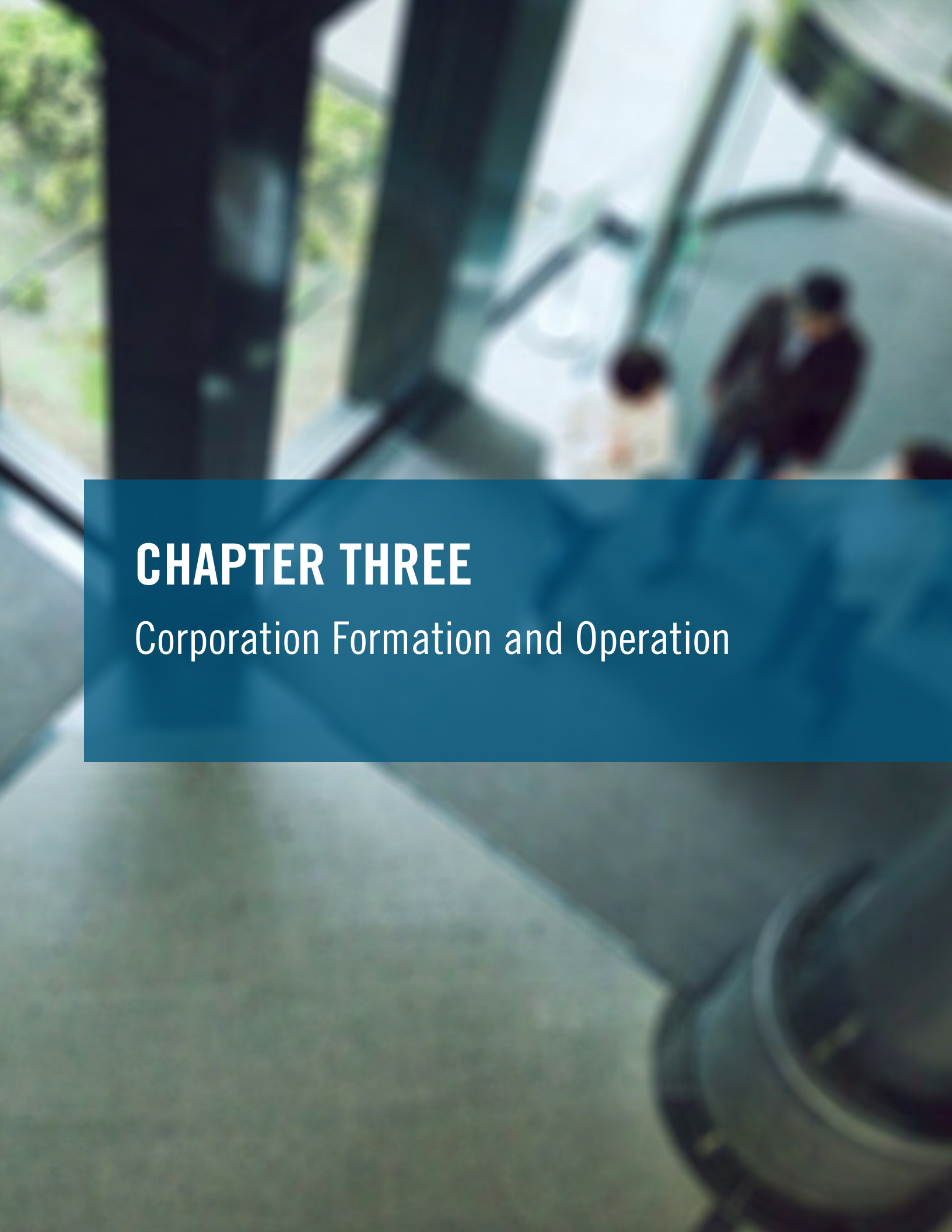
In addition to traditional limited liability companies, certain states have implemented an alternative "series limited liability company" that permits a parent limited liability company to establish one or more series that can have its own assets, members, managers, and purposes. Properly designed series limited liability companies may permit insulating each series from the liabilities or obligations of the other series under the same parent. The liability implications and tax considerations in using a series limited liability company are complex, and consulting a knowledgeable and experienced professional in the United

States is recommended when considering the circumstances in which operating through a series limited liability company may be beneficial as compared to a traditional limited liability company.

One of the drawbacks of limited liability companies is that they are not eligible in the United States to participate in tax-free reorganizations 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-deferred exchange for stock of a publicly traded company may be limited.

E. Securities Laws

As discussed in more detail in Chapter 6, *Regulation of Non-U.S. 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 laws, 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 THREE

Corporation Formation and Operation

Chapter Three

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. Attached to the end of this guidebook as **Attachment 1** is a flow chart indicating the steps in the process of forming a corporation or limited liability company.

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 U.S. 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, Delaware law requires 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 pre-existing 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 14, *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, it is important at the outset of a new business operation in the United States that the proposed name (as well as proposed trade names, identifiable slogans, and marks) be evaluated to assure that its use can be protected, with a reasonable degree of certainty, and will be free of interference from those claiming prior superior rights.

Non-U.S. companies and their U.S. 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 14, *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 state's designated 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 non-U.S. 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 non-U.S. 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 U.S. taxation purposes (*see* Chapter 5, *Taxation of United States Operations*).

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

- Name of the corporation;
- Number of shares of stock that the corporation is authorized to issue;
- Name of the registered agent and address of the registered office of the corporation; and
- 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, and many state laws require that certain provisions be expressly set forth in the Articles of Incorporation. For instance, many corporations provide in their Articles of Incorporation that members of the board of directors will have no personal liability for monetary damages for actions taken by them in that capacity subject to any limitations imposed by statute. 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 of Incorporation.

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 of Incorporation in order to confine the scope of the entity's operation and to put the public on notice (through the Articles of Incorporation) 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, but 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. Lawyers and accountants typically do not serve in that capacity, so if a non-U.S. 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 U.S. 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 U.S. business entity and not with its owners or an affiliate. Of course, the U.S. business entity can have commercial dealings with its non-U.S. parent or an affiliated company, but those relationships should be documented and conducted in the same way as would be done with an unaffiliated third party.

The U.S. 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 U.S. 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 U.S. 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 U.S. business entity. Guaranties should be carefully considered and documented.

Insurance can also be an effective means of safeguarding the value of a non-U.S. parent company's investment. The U.S. 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 lawyer 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.); and
- Any other matters that require authorization or approval of the board of directors.

II. Issuance of Stock

Pursuant to authorization from the board of directors, 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 U.S. entity so that the stock issuance can be properly effected. At the discretion of the organizers of the corporation, the stock issued to the owners can be evidenced by either (i) a physical stock certificate, or (ii) through an electronic book entry system maintained by the corporation without the need for a physical stock certificate.

III. Debt vs. Equity

One of the initial considerations for the owners of a U.S. 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 5, *Taxation of United States Operations*, there may be advantages to injecting funds through loans rather than as equity capital. However, if such “loans” are not advanced on commercially reasonable terms (including tenor, yield, and remedies) those benefits may not be realized. As is true with third-party loans, an important consideration in evaluating the reasonableness of the terms of an advance is the amount of debt, relative to equity capital, of the borrower. A properly structured loan generally entitles the borrower to deduct interest payments, and may entitle a non-U.S. parent company to a more favorable treatment, from the standpoint of U.S. withholding tax, on those interest payments than it might on dividend distributions (discussed in Chapter 5, *Taxation of United States Operations*). Importantly, while any advance intended to be a loan for income tax purposes should be clearly documented and contain customary loan terms and provisions, such documentation does not ensure the advance will be treated as debt for income tax purposes. State taxation can also play a role in structuring optimal capitalization.

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

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 majority vote 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 voting power held by the corporation's stockholders or members of the board of directors (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 (for example, 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 U.S. immigration laws or unintentionally subject them to U.S. taxation (*see* Chapter 9, *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:

- Quorum and voting standards for the conduct of business at stockholders and directors meetings;
- Authorization of action without a meeting (by written consent) if the appropriate number of signatures are obtained;
- Number, term, qualification, election, and removal of directors;
- Authorization of various committees or the method by which committees may be established;
- Manner and time frame for giving notice of meetings of stockholders and directors;
- 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 and transfer of stock by either physical stock certificate or electronic book entry;
- Records and financial statements required to be maintained (if any); and
- Provisions indemnifying officers and directors for expenses and other liability incurred in carrying out their duties, if appropriate.

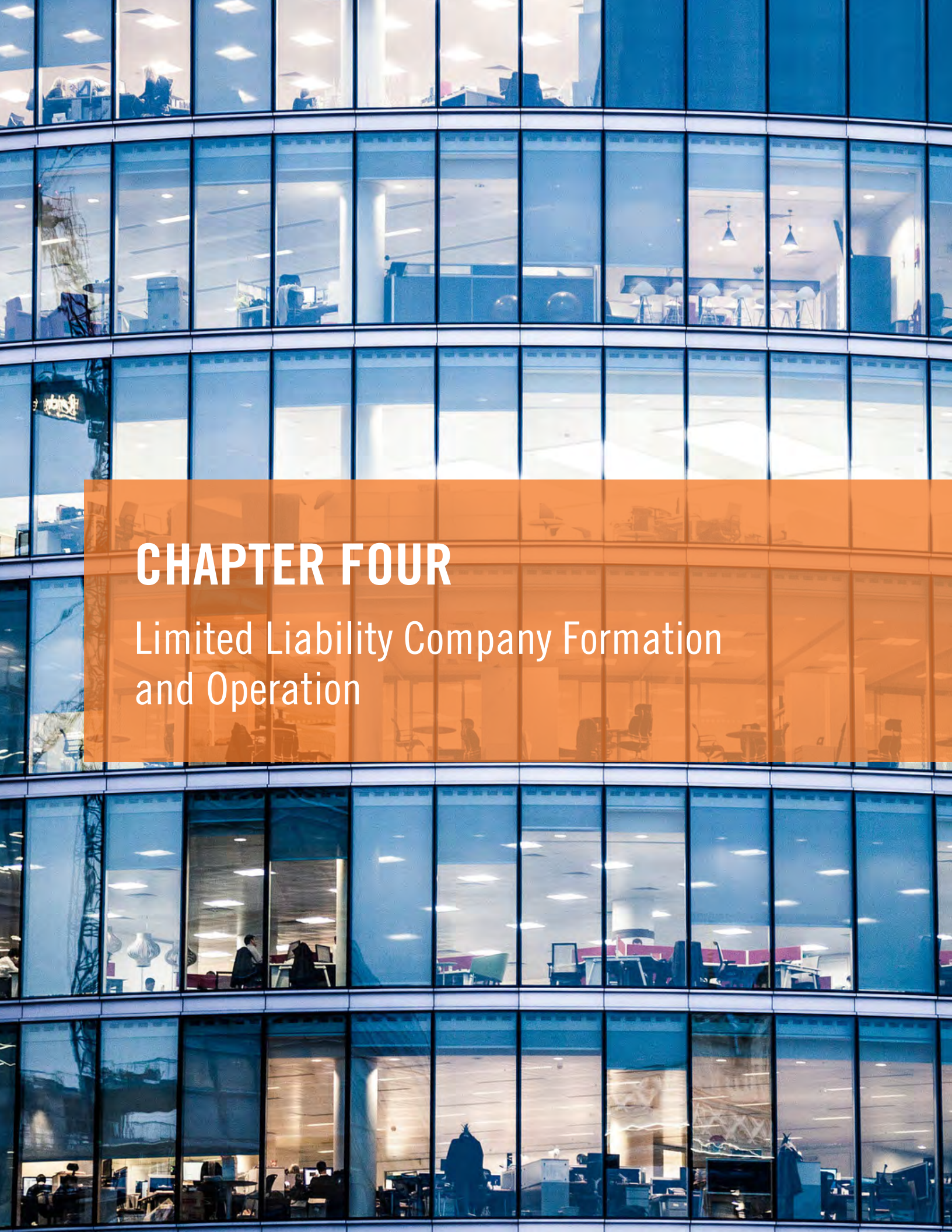
In addition to the bylaws, it is sometimes advisable for the stockholders to enter into an agreement governing their rights as stockholders. Such an agreement is not necessary when a corporation is owned solely by one entity or individual, but if stock is issued to several stockholders, the majority stockholder may wish to have the other stockholders (the "minority stockholders") execute an agreement imposing transfer 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; and
- Restricting voting rights or imposing other restrictions applicable to the minority stockholders, as warranted.

On the other hand, the minority stockholders may want such an agreement to address the election of directors, including any directors to be nominated by the minority stockholders, and veto rights over a list of fundamental activities of the corporation, such as liquidation, significant acquisitions, and amending charter documents.

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 FOUR

Limited Liability Company Formation and Operation

Chapter Four

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 common principles referenced in Chapter 3, *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 greater 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 fewer statutory counterparts in the limited liability company context. State laws give wider latitude to the owners ("members") with respect to the economic and governance arrangements of a limited liability company. Those arrangements are set out in a document, negotiated by the members, typically 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 1**.

I. Entity Name

Just like corporations, limited liability companies must clearly identify themselves to the public as that form of business entity. 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.; or
- 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 3, *Corporation Formation and Operation*.

II. State Formation Filings

Limited liability companies are formed by filing a formation document with the appropriate state office of the Secretary of State. In many states, that document is entitled "Articles of Organization," while in

Delaware it is called the “Certificate of Formation.” The formation document (hereafter, Articles) typically contains some or all of the following information:

- 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;
- Name and address of the person signing the Articles and whether that person is acting as the organizer or other authorized person or as a member (an owner of the limited liability company);
- 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; and
- 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 either or both the Articles and the Operating Agreement, as appropriate under applicable state law). The latter approach creates what is called a “manager managed” limited liability company and, to the extent included in the Articles, 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 may delegate their authority and duties to others and may appoint officers with titles similar to those used in the corporate context (e.g., 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 with U.S. operations may subject the foreign national to U.S. income taxation.

III. Registered Agent and Office

Similar to a corporation, the registered agent of a limited liability company must reside or maintain an office (which will be the company’s registered office) 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 good housekeeping practices as are set out for corporations in Section A.IV. of Chapter 3, *Corporation Formation and Operation*.

B. Members and Managers

A member of a limited liability company becomes one either by being named as a member in the Articles (if applicable state law so provides) 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 6, *Regulation of Non-U.S. 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 typically set forth in an Operating Agreement (including the voting rights of various members) in order to modify or confirm those that would otherwise apply under the applicable state statute. Certificates or other evidence of ownership typically are not issued by limited liability companies, unlike corporations that issue shares of stock.

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., charter, 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. Scope of the Company's Business

Limited liability companies can be formed either for specific purposes or for any lawful purpose. Whether a limited liability company is formed for a general purpose or a more specific one will depend upon the circumstances, including the relationship of the members to each other. The scope of the limited liability company's business, even when general, is typically included in the Operating Agreement. The purpose or business of the limited liability company may impact the actions that the members or managers may take on behalf of the limited liability company as, generally, a limited liability company does not have the power to engage in business beyond that set forth in its Operating Agreement.

II. Initial and Additional Capital Contributions

Operating Agreements often 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. For a limited liability company treated as a partnership for income tax purposes, such contributions serve as the starting point for each member's "capital account" to be taken into account when considering relative rights to operating and liquidating

distributions. 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. In many cases, however, the members may not want to commit themselves to further capital contributions, and this is an important understanding to have reflected in the Operating Agreement. The provisions of the Operating Agreement addressing capital contributions typically outline the procedure for additional capital calls from the members, if any, 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 and reflect in the Operating Agreement any procedures that fit their needs.

III. 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 or other voting percentage 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 or managers might be required. Actions that might fall into that category include admission of new members, subjecting the members to personal liability, incurring significant debt, dissolving the limited liability company, 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.

When the limited liability company will be managed by managers, it is important that the Operating Agreement contain provisions specifying how, and by whom, managers may be appointed and removed and any qualifications necessary to serve as a manager of the limited liability company.

IV. Fiduciary Duties, Exculpation, and Indemnification

Unless specifically modified by the Operating Agreement, the members and managers of a limited liability company may have certain fiduciary duties to the limited liability company or to its members by default under applicable state law. Often such default duties will include a duty of care and a duty of loyalty similar to those required of directors and stockholders of a corporation. However, applicable state law often permits members in an Operating Agreement to define those duties, including expanding, restricting, or in certain states even eliminating any such duties. Operating Agreements, therefore, often specify the standards of care and other duties that the members intend to apply with respect to the members or managers, including whether or not certain business opportunities that may present themselves to a member or manager must first be offered to the limited liability company before the member or manager can pursue or engage in that activity outside of the limited liability company.

In addition, the Operating Agreement usually will provide for exculpation from liability of the members and managers to the limited liability company and its members, unless they fail to meet certain specified standards of care or act in a manner that the Operating Agreement specifies will not protect them from liability (e.g., gross negligence, willful misconduct, fraud, etc.). Similarly, the Operating Agreement will

typically provide for mandatory indemnification by the limited liability company for losses incurred by the members or managers in defending legal actions or similar proceedings against them relating to their acting in such capacity on behalf of the limited liability company, including advancement of legal fees prior to final disposition, assuming such actions did not violate the same standards as set forth in the Operating Agreement for their exculpation.

V. 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 profit or loss on their tax returns. "Distributions" (described below) refer to the transfer of cash or other property 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 each class of stockholders (in their capacities as such) on a pro rata basis, in accordance with the number of shares of stock of such class held by each of them.

As set forth in Chapter 5, *Taxation of United States Operations*, a limited liability company treated as a partnership generally 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. A single member LLC is generally treated as a branch of its owner for income tax purposes. As a result, a limited liability company itself generally pays no U.S. federal income tax (although a few states impose income taxes on limited liability companies in a fashion comparable to corporations). Limited liability companies are, in some instances, able to elect to be treated as corporations for federal income tax purposes, which elections should only be considered with guidance from a knowledgeable and experienced tax advisor.

VI. Distributions

The flexibility of limited liability companies permits the members to agree in the Operating Agreement on how distributions of cash and property are to be made by the limited liability company. 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, for instance, 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.

VII. Transfer Restrictions and Buy/Sell Provisions

Under most applicable state law, an interest in a limited liability company is freely assignable by default. Therefore, the Operating Agreement will typically provide the terms and conditions under which an interest in a limited liability company may be transferred. These restrictions may include requiring the prior consent of some or all members or managers, the assignee having to agree to be bound by the terms of the Operating Agreement, certain technical requirements to comply with applicable securities or other similar laws, or other restrictions or requirements as the members may agree. Often the restrictions will speak to both direct and indirect transfers so as to prevent the effective transfer of the interest through a change of control of the member. Conversely, the Operating Agreement sometimes contains exceptions to transfer restrictions for transfers by a member to affiliated entities or for estate planning purposes.

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 3, *Corporation Formation and Operation*.

Unlike with a corporation, where a holder of stock is generally a “stockholder” for all purposes, under the applicable law of most states, a holder of an interest in a limited liability company is not necessarily automatically a “member” of the company. Rather, there is typically a distinction between simply holding an interest in a limited liability company (e.g., as an assignee) and being admitted as a member of the limited liability company in respect of such interest. The former generally only means that the holder is entitled to the economics associated with the interest (i.e., distributions and allocations), while membership carries with it the other rights associated with being a member of the limited liability company (e.g., voting rights). For this reason, the Operating Agreement usually addresses not only provisions relating to transfers of interests, but also the requirements and mechanics for the transferee of the interest to be admitted as a member of the limited liability company in respect of that interest.

VIII. Amendments

An Operating Agreement is a contract, and like most contracts the Operating Agreement typically contains provisions relating to its amendment. Under the law, including general contract law, of most states, if the Operating Agreement is silent, it can likely be amended by the approval of all of the members or other parties to it. Often, however, the members desire the flexibility to amend some or all of the provisions of the Operating Agreement by less than unanimous approval. If so, they should provide in the Operating Agreement the necessary percentage in interest of members required to amend the Operating Agreement, as well as specify which, if any, provisions of the Operating Agreement can be amended by the managers without any member consent or require the consent of a higher percentage or all of the members to amend.

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. A single member LLC may be required to obtain its own taxpayer identification number if it will have employees. Further, while the limited liability company is

typically not a taxpayer itself (passing through all items of income and loss to its members), a multi-member limited liability company is generally 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. A limited liability company that has elected to be treated as a corporation for income tax purposes may have additional obligations, and such elections should only be considered with guidance from a knowledgeable and experienced tax advisor.

CHAPTER FIVE

Taxation of United States Operations

Chapter Five

TAXATION OF UNITED STATES OPERATIONS

A. Introduction

Rather than stray into the thicket of particulars surrounding U.S. taxation of business operations of non-U.S. companies, this Chapter discusses the general framework and principles underlying that taxation scheme.

The U.S. federal 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, federal tax laws are enforced at the federal level by the Internal Revenue Service.

While there are many exceptions, the U.S. federal 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 U.S. economy. However, achieving that laudable goal requires significant complexity.

Within the United States, individual states and local jurisdictions also separately impose their own taxes, and state Departments of Revenue, Comptroller's offices, or similar agencies generally enforce such taxes at the state level (certain local taxes, such as real and personal property taxes, are enforced by local taxing authorities or similar agencies). While some state and local income and business taxes are calculated in a manner similar to federal income taxes, many state and local taxes deviate to varying degrees from federal tax calculations or simply do not have a comparable federal counterpart, so specific attention should be paid to the state and local taxes applicable in the jurisdictions in which a company conducts business and into which it sells or delivers products and services.

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

B. Effect of Tax Treaties

When evaluating U.S. 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 non-U.S. 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 non-U.S. company is a qualifying resident of 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 U.S. source income is taxed. Treaties also have an impact on the

taxation of distributions of net profits from U.S. 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. One example of such restrictions is the "limitation on benefits" provision included in most U.S. tax treaties that limit the application of a treaty to qualifying residents.

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 2, *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 U.S. taxing jurisdiction as a result of the subsidiary being organized in the United States. Repatriation of earnings of the subsidiary to the non-U.S. parent company, as well, will be subject to U.S. 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 non-resident and corporate stockholder restrictions, corporate subsidiaries of foreign companies are not eligible for S corporation classification.

U.S. 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 generally to be filed within three 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 U.S. 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 U.S. 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 U.S. 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 percent of dividend and interest payments are to be withheld by the U.S. subsidiary and remitted to the Internal Revenue Service.

Those rates typically are reduced if the parent company is a qualifying resident of a country that is a treaty partner with the United States. Under those tax treaties, the withholding rate on **interest** payments to the non-U.S. 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 U.S. subsidiary, the terms and conditions of intercompany indebtedness must be commercially reasonable in order for the arrangement to be respected as “debt” for U.S. 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) that 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. Even if a chosen interest rate is appropriate, recently implemented rules limit the deductibility of interest based on a percentage of the earnings of the borrower.

Under recently finalized rules, certain intercompany debt instruments are automatically recharacterized as equity in the issuer if issued to certain related parties (i) in a distribution, (ii) in exchange for related-party stock, or (iii) in exchange for property in certain asset reorganizations. These rules also recharacterize as equity any debt instrument issued to certain related parties in exchange for money or property to fund such a transaction. An expansive rule treats a debt instrument issued during the period beginning 36 months before and ending 36 months after a covered transaction as funding the related transaction.

These rules have been subject to numerous changes, and the Internal Revenue Service continues to study how they may be further modified.

D. Direct Operations in the United States

I. If No Applicable Tax Treaty

If a non-U.S. 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 non-U.S. 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 U.S. 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 U.S. 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 U.S. operations. That inquiry requires a complicated segregation and apportionment analysis of the worldwide operations of the non-U.S. 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 non-U.S. company is a party to a tax treaty with the United States, different rules apply. While each treaty has its own unique features, most U.S. tax treaties impose U.S. taxation only if a non-U.S. 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 non-U.S. company will have a permanent establishment in the United States if it conducts business through an office or 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 corporate U.S. subsidiary will not result in the non-U.S. 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 non-U.S. company has a permanent establishment in the United States, it will be taxed on its income attributable to that permanent establishment. Analysis of income "attributable to" those U.S. operations is somewhat different than determining "effectively connected" income in the non-treaty context, but generally less expansive.

III. Entity Classification

When a non-U.S. company is directly subject to U.S. taxation, its classification for U.S. tax purposes will be important. Typically, the non-U.S. company will be classified either as a "corporation" or as a "partnership" for U.S. tax purposes. That determination is complex, however, and sometimes unpredictable. For instance, there are a number of entities that are required to be treated as corporations for U.S. tax purposes. Those include entities such as German Aktiengesellschafts and United Kingdom Public Limited Companies. Some entities can elect their classification for U.S. tax purposes.

IV. Branch Profits Tax

If a non-U.S. company operates directly in the United States either through a "permanent establishment" (under a treaty) or by conducting a U.S. "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 U.S. income tax on the income attributable to its U.S. operations.

As noted above, the U.S. 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 U.S. operation of a non-U.S. company in an amount comparable to the withholding tax that would have been imposed on dividends repatriated by a U.S. corporate subsidiary to its non-U.S. parent company.

Since branches or divisions of a non-U.S. 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 U.S. division to the home country of the non-U.S. 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 U.S. subsidiary to its non-U.S. parent company that the branch profits tax attempts to tax. 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 non-U.S. parent company sells machinery produced in its home country to its wholly owned U.S. subsidiary at an inflated price, the profits of the U.S. 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 U.S. subsidiary and additional tax owed to the U.S. 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. Recent international action to combat tax avoidance through "base erosion" or "profit shifting,"

particularly with respect to the ownership and exploitation of intellectual property, has made transfer pricing considerations increasingly important.

F. State and Local Taxation

Most states and some local jurisdictions impose their own income or other business taxes on enterprises conducting business within or making sales into their jurisdictions. Businesses with permanent physical operations in a state will almost certainly have some business tax liability in such state; however, even businesses without a physical presence in a state may become subject to that state's taxing jurisdiction either because of activities they conduct in the state or because their sales of products or services into the state exceed a designated minimum threshold. Because some states do not follow federal tax treaties, protections provided at the federal level by a treaty will not necessarily apply to some state income and business taxes. In many cases, state income or other business taxes are calculated similarly or by reference to the federal income tax. Taxpayers subject to tax in more than one state may generally apportion or allocate their income among the states according to the relative levels of their business in the states; however, because apportionment and allocation rules differ among the states, it is possible for some taxpayers to effectively pay state income or business tax in the aggregate across all states on greater than 100 percent of their federal income.

In addition to income taxes, many state and local governments impose other taxes, including sales and use taxes, gross receipts taxes, employment taxes, franchise taxes, local taxes on real and personal property, and various excise taxes. As with state business taxes, taxpayers may have liabilities for other state and local taxes even if they do not have permanent physical operations in that state. For instance, taxpayers that have never physically entered a state could nevertheless be required to comply with a state's sales and use tax requirements, if the taxpayer's sales into the state exceed that state's designated minimum dollar amount or minimum number of transactions. A non-U.S. business seeking to commence or expand operations in the United States should carefully plan not only with federal tax in mind but also for state tax compliance and efficiency, including by considering its prospective operational footprint, the locations of its customers, and the taxing jurisdictions where it expects to perform business activities.

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

The 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 U.S. "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 16, *Owning and Leasing Facilities in the United States*.

H. Foreign Nationals in the United States

If nationals of a non-U.S. country are "substantially present" in the United States during a calendar year or if they become lawful permanent residents of the United States, those individuals will be considered U.S. residents for federal income tax purposes and will be required to file U.S. tax returns. Subject to certain limited exceptions, if a non-U.S. national is present in the United States on at least 31 days of the current

calendar year, the individual will be "substantially present" in the United States if the sum of the following equals 183 days or more:

- The actual days in the United States in the current year; *plus*
- One-third of the days in the United States in the preceding year; *plus*
- One-sixth of the days in the United States in the second preceding year.

Of course, those non-U.S. nationals also will have to comply with the immigration laws of the United States, which are discussed in Chapter 9, *Immigration Law*.

Nationals of a non-U.S. 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 non-U.S. national who 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 generally 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 U.S. 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 non-U.S. investors. The federal and state tax laws applicable to non-U.S. investment in U.S. partnerships and limited liability companies can be exceedingly complex, requiring guidance at an early stage from knowledgeable and experienced tax advisors.

CHAPTER SIX

Regulation of Non-U.S. Companies

Chapter Six

REGULATION OF NON-U.S. 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. These laws range broadly, including from required inspection of foods to restrictions against employment discrimination, and are implemented, in many cases, through governmental agencies. Non-U.S. companies doing business in the United States are subject to the same laws and restrictions as are U.S. 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 non-U.S. 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 (IISA)

The U.S. Congress enacted 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 11, *United States Business Acquisitions*.

Based on data received, the Bureau of Economic Analysis (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 into the United States.

C. Agricultural Foreign Investment Disclosure Act (AFIDA)

In order to determine the extent to which agricultural lands in the United States are being acquired by foreign interests, the U.S. Congress enacted a law known as AFIDA. AFIDA applies to any foreign person (meaning individual or legal entity) 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 United States Secretary of Agriculture. Failing to file (or filing an incomplete, misleading, or false report) can result in civil penalties of up to 25 percent 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 six months of filing.

D. Currency and Foreign Transactions Reporting Act (CFTRA)

In order to monitor currency flows in the United States and their effect on the integrity of the U.S. financial system, the U.S. Congress enacted CFTRA (also known as the Bank Secrecy Act). CFTRA is an effort to curb money laundering and other illegal activities. Under CFTRA, the import or export of monetary instruments (including currency, traveler's checks, checks, and money orders) in excess of US$10,000 by

any person, including a non-U.S. person, must be reported to U.S. 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 (HSR Act)

Evaluating antitrust implications of large acquisition transactions is the purpose of the HSR Act. The HSR Act has broad application (which may surprise many non-U.S. 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 revenues of the entities or assets to be acquired are attributable to the United States. For further detail concerning the applicability of the HSR Act, *see* Chapter 11, *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 U.S. 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 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 11, *United States Business Acquisitions*.

G. Foreign Agents Registration Act (FARA)

FARA was enacted by the U.S. Congress in order to gather information concerning the activities of foreign interests seeking to influence U.S. 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 United States Attorney General within 10 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 consular 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 United States Attorney General within 48 hours of such materials' transmittal (which filings are made available for public inspection). Failure to comply with FARA 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 U.S. 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 of securities 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 U.S. 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 partnership and limited liability company interests, notes, investment contracts, and various other investment interests.

Consequently, whenever an activity of a non-U.S. company involves the offer or sale of securities in or through the U.S. markets (including securities that originate outside the United States), the offeror should seek advice concerning implications under U.S. securities laws. In many cases, exemptions, scaled disclosure requirements, or expedited approvals are available, but absent the advice of professional advisors, the exemptions should not be assumed or relied upon.

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. Offerors should review with securities law counsel the applicability of those laws and their relationship to federal laws.

I. Government Contracting

Non-U.S. 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 U.S. 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." If a business operates in other jurisdictions (for instance, a corporation domiciled in Delaware does business in Texas, as well), the business will be required to "qualify" to do business in those other jurisdictions (Texas in the prior 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 3, *Corporation Formation and Operation*). Qualification typically requires payment of an initial fee, a

recent certification of existence from the state of domicile, annual reports, and additional fees due annually. It is a straightforward process with initial approval typically within 24–48 business hours.

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.

Note that the level of activity in a state will also 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. For further detail concerning state taxation, *see* Chapter 5, *Taxation of United States Operations*.

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 website.

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). In certain jurisdictions, a portion of these property taxes and/or license fees can be reduced through local economic development incentives (*see* Chapter 1, *Operations in the United States*). 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 non-U.S. company is considering providing these types of services (even if only ancillary to the sale of products being manufactured), a thorough review of potentially applicable regulations should be undertaken before proceeding because fines for noncompliance can be significant.

CHAPTER SEVEN

Sales Representatives and Agents

Chapter Seven

SALES REPRESENTATIVES AND AGENTS

A. Necessity of Clear Contract Terms

Many non-U.S. companies enter U.S. markets by first using independent sales representatives. Depending on those results, the progression is then to use true direct agents and ultimately to implement full-scale operations in the United States. As a non-U.S. company moves along that continuum, exposure to U.S. taxation and other regulatory requirements increases commensurately, as discussed in detail in other Chapters.

Wherever a non-U.S. 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 written contract between the parties largely will determine their relative rights and duties. Notably, non-U.S. companies sometimes discover that they have entered into arrangements exposing themselves 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 non-U.S. company, the contract should state this. This will be important when determining, for U.S. tax purposes, whether a non-U.S. company has a “permanent establishment” in the United States. As noted in Chapter 5, *Taxation of United States Operations*, one factor used in determining whether a permanent establishment exists is whether an agent or employee of the non-U.S. company is present in the United States and has the power to contract on behalf of the non-U.S. company or take other comparable action. If a non-U.S. company wishes to avoid permanent establishment status, the contract with the sales representative or agent should expressly exclude those powers. Be aware as well that merely stating that a person is an “independent contractor” does not necessarily confirm that status. As discussed in Chapter 8, *Employment Law (Federal and State)*, the facts and circumstances of the particular relationship, and not the written contract, will determine whether the person is considered an independent contractor or an employee.

C. Scope of Duties

Each contract should clearly state (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 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 non-U.S. company may be investing a significant amount of capital in its U.S. initiative, and it may be financially exposed unless the sales representative or agent performs the services required for a sufficient time to enable the non-U.S. company to gain a foothold. In other circumstances, a brief engagement may be all that is needed to initiate U.S. 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 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 company's business reputation; and
- 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 the provision that addresses 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 almost inevitably result.

Sales representatives and agents sometimes prepare the contract themselves and present it to the 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 non-U.S. 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 non-U.S. 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 non-U.S. company intends to pay commissions only for sales (i) that are procured primarily through the efforts of the sales representative or agent, (ii) that have closed during the term of the contract, and (iii) for which the 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 non-U.S. company also should be careful to carve out from any commission arrangements the sales to existing customers of the 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 company and the sales representative or agent following termination. If commissions are to be paid for orders that arise from the sales representative's efforts during the term of the contract, but 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 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 confidentiality, return of the company's property by the sales representative or agent, tampering with contractual relationships of the company, and related matters.

F. Disputes

When disputes over commissions and compensation arrangements arise, the reaction of the 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 damages and charges may be assessed against the company. This is another reason to make sure that the contract terms provide abundant flexibility for the 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 nonbinding 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 10, *Supplier and Customer Contracts*, for further discussion of dispute resolution alternatives and applicable international conventions.

G. Other Provisions

Other provisions that a non-U.S. company should consider including in a contract with a sales representative or agent are those dealing with:

- Restrictions on representing competing products during and for a period after the contract;
- Representations and warranties by the sales representative or agent that there are no restrictions precluding his or her performance under the contract;
- Confidential and proprietary information and inventions;
- The territory covered by the contract;
- Limitations on statements that can be made by the sales representative or agent about the products;

- Restrictions on the ability of the sales representative or agent to bind the company;
- Terms and conditions on which orders are to be submitted;
- Indemnity provisions;
- Expense reimbursement policies; and
- Confirmation of independent contractor status.

CHAPTER EIGHT

Employment Law (Federal and State)

Chapter Eight

EMPLOYMENT LAW (FEDERAL AND STATE)

A. Employment Relationship

The relationship between an employer and employee in the United States can be very different from that in other countries. This Chapter sets forth some of the peculiarities of U.S. employment law of which non-U.S. 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 companies setting up operations in the United States find it helpful to have someone familiar with U.S. 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 many 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 arising from it.

B. At Will Employees

Unlike some countries, U.S. 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 by either party), unless otherwise provided in a contract between the employer and employee. In an "at will" employment 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. In addition, some mass terminations may require 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) duties, (iv) exclusive services, (v) noncompetition and/or nonsolicitation provisions, (vi) protection of confidential information, (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) severance.

While comprehensive employment contracts may not be appropriate for rank and file employees, it is common to provide these employees with an offer letter at the outset of their employment, describing the position, compensation, classification, and any conditions to employment. It may also be important to require those employees to sign short agreements protecting the company's rights in confidential information and intellectual property developed by those employees during their employment, depending on the scope of their job.

Although employment contracts have their benefits, they must be carefully drafted to maintain an employee's at-will status. Specifically, contracts containing certain employee protections, such as indicating a specific term of employment (for example, two years), specifying a notice of termination period, or permitting only termination for just cause, can 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 and routinely updated and enforced by the employer, can help protect the employer from liability when employment disputes arise. Employers should strive to strike a balance between clearly communicated polices and avoiding excessive detail that would require frequent updating. Certain policies may be mandated by various federal, state, and local employment laws where applicable, such as laws relating to leaves of absence, sick time, and parental leave, and laws relating to anti-discrimination and anti-harassment.

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*. Consideration is the exchange of something of value in return for the promise or service of the other party—like a one-time payment of money or an increase in salary or job position. 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 that the executive and the company entered into the initial employment agreement, the new supplemental agreement may not be enforceable against the executive unless the executive is given some additional valuable consideration at the time that 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 proprietary information, customer relationships and goodwill, and a market for its products, and the employee has likely accessed certain trade secrets or confidential information. Employees who work for the company are beneficiaries of that investment and goodwill, 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 or work for a competitor.

If properly structured, these types of restrictive covenants are enforceable in most jurisdictions in the United States, though certain jurisdictions consider noncompetition covenants void or unenforceable against certain employees. Most jurisdictions construe them very narrowly and look for reasons not to enforce them. 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. Further, most jurisdictions require that the restrictions be reasonable in (i) time of duration, (ii) the territory in which the restrictions apply, and (iii) the scope of the employee's restricted activity.

As noted earlier, these types of restrictions require adequate consideration in order to be enforceable. Consequently, many states require that they should be imposed only as part of the initial employment offer or be accompanied by significant consideration if imposed after an employee has commenced performing services.

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. Employees should be given the opportunity to list and exclude inventions created prior to the employment relationship for clarity.

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 default assumption of these laws is that a worker is an "employee." Generally, the most significant distinction between the two categories of workers is the method by which they receive payment and how taxes and withholdings are handled. Individuals classified as "employees" are assured to the government that their "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, and the burden is on the independent contractor to handle taxes.

Because of the regulatory bias, a business must be very cautious when treating a worker or representative as an 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.

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 (which vary by jurisdiction) 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. If an independent contractor is determined by a regulatory agency to actually be an employee, the employer may be liable for, among other things, (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 (for example, overtime pay requirements and pension plan inclusion). Civil and criminal penalties may also apply in certain circumstances.

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 some 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 who 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. Wage and Hour Requirements

The federal Fair Labor Standards Act classifies most employees into one of two categories for the purposes of overtime and minimum wage payment: exempt and nonexempt. Nonexempt employees are entitled to be paid at least a federal minimum wage and also receive overtime pay. Exempt employees, who are most commonly paid on a salaried basis regardless of the number of hours they work, receive neither of these protections. The regulation's default assumption is that an employee is nonexempt, but there are certain categories of employees that qualify for exemption from overtime pay. In the United States, the typical workweek is 40 hours per week. Federal law requires that most nonexempt employees be paid at least the federal minimum wage for all hours worked and overtime pay at not less than time and one-half the regular rate of pay for all hours worked over 40 hours in a workweek. If an exempt employee is determined by a regulatory agency to have been misclassified and actually to be a nonexempt employee, the employer may be liable for (i) unpaid wages, including unpaid overtime, and (ii) liquidated damages in an amount equal to the sum of the unpaid wages that the employee is owed.

State and local laws governing wage and hour requirements, including employee classification, are generally modeled after those contained in federal regulation. In some cases, however, state and local laws may impose additional conditions on employers, including additional overtime pay premiums or more generous minimum wage protections, or recognize additional exemption criteria.

H. 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 nonunion workforce. However, there are certain industries even in those states that are unionized. Other states, especially those in the Northeast, such as Pennsylvania, Massachusetts, New Jersey, and New York, are more 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.

I. Anti-Discrimination Laws

Even if an employer is operating under "at will" employment principles, and without contract restrictions, federal, state, and local laws in the United States protect certain classes of individuals from discriminatory, harassing, or retaliatory actions in the employment context. Those laws are many and varied, but a sampling of federal laws 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 ADA; 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.
Section 1981 of the Civil Rights Act of 1866 42 U.S.C. § 1981	Prohibits discrimination on the basis of race, color, and ethnicity when making and enforcing contracts.	All private employers and labor organizations.

J. Other Employment-Based Laws

In addition to the laws referenced above, there are other potentially applicable federal, state, and local 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 and sets minimum standards for the management and funding of the 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 nonexempt 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.
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 weeks in the current or preceding calendar 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.

Federal Law (common name)	Summary	Coverage
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 notable 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); and
- Vietnam Era Veterans' Readjustment Assistance Act of 1974 and Executive Order 11701.

K. Employee Benefits

While there are very few employee benefits that are mandated by state or federal law, a non-U.S. 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 U.S. 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.

Non-U.S. companies also should also 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 is 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.

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 that authorizes that particular variant).

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. 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 protected 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.

L. Plant Closing and Layoff Regulations

Although it may never be applicable to them, all employers should be aware of the federal 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 six 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. Broadly speaking, the advance notification requirements may be triggered where (i) at least 50 employees are affected by a plant closing, (ii) 500 or more workers are laid off at a single site of employment, or (iii) 50–499 workers are laid off at a single site of employment where the layoffs constitute 33 percent of the employer’s total active workface at the single site.

The rules of WARN are complicated and can apply in unusual ways. For instance, there is a “look back” and “look forward” testing period during which all layoffs within that test period will 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. There are three exceptions to WARN's notice requirement: (i) faltering company, (ii) unforeseeable business circumstances, and (iii) natural disaster.

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 prior to the acquisition, 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.

M. 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, which may be evidenced by the "employee handbook." 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 lawyer's fees and liquidated damages as well.

CHAPTER NINE

Immigration Law

Chapter Nine

IMMIGRATION LAW

A. Central Role of Immigration Laws

In the United States, companies can only employ persons who are eligible to work in the United States. For U.S. citizens and lawful permanent residents, the right to work is automatic. For other persons, eligibility to work in the United States requires pre-approval by the Department of Homeland Security (DHS). DHS issues a variety of different documents to establish non-citizens' right to work, such as employment authorization cards, arrival/departure record cards, or the permanent resident alien card—affectionately known as the "green card" (although many of them are not actually green).

If a company does not recognize immigration issues inherent in the employment context, it can unknowingly violate the Immigration and Nationality Act (INA) or the Immigration Reform and Control Act (IRCA). The basic concepts of those laws are highlighted below, as are the most common visa types 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 potential loss of visas, lawful permanent resident status, or other benefits. Companies who employ unauthorized workers or fail to confirm employment eligibility for each employee 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 U.S. immigration laws and access to professional advisors that can deal with the particulars.

B. Immigration Status

A foreign national's ability to work in the United States is mainly determined by his or her immigration status. The primary employment-related status classifications under the immigration laws of the United States are summarized as follows:

I. Undocumented Aliens

An undocumented alien is a foreign national without a formal immigration status. Typically, undocumented aliens include persons who entered the United States without inspection or who were admitted properly but overstayed their period of admission. The term "undocumented" refers to the fact that such persons are not authorized to work and cannot be lawfully hired in the United States.

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** (e.g., to visit, study, work in a particular job for a particular employer, etc.). There are many categories of nonimmigrants in the U.S. immigration system, some of which allow for employment. The term "nonimmigrant" generally refers to the fact that the person is not immigrating permanently and is given only temporary status.

Most nonimmigrants enter the United States with a visa stamp matching their specific nonimmigrant category. Although the visa is an important travel document, it does not establish eligibility to work in the

United States. A foreign national presents the visa to customs officials when seeking admission to the United States. Once customs admits the person, he or she is given a nonimmigrant visa classification, which usually is stamped into the passport and referred to as the "I-94 Arrival/Departure Record." This I-94 Arrival/Departure Record is also available online at **https://i94.cbp.dhs.gov/I94/#/home**. It is important to note that the period of authorized stay shown on the I-94 Arrival/Departure Record very often does not match the expiration date of the visa. This inconsistency is due to the fact that the visa itself is only an entry document, whereas the I-94 Arrival/Departure Record is the official proof of someone's nonimmigrant status. The I-94 Arrival/Departure Record, not the visa stamp, is the most important indicator 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 Record, is "out of status." This can occur if a foreign national stays in the United States beyond the expiration date of his or her status or if that person engages in employment in the United States that has not been authorized by the U.S. Citizenship and Immigration Services (USCIS).

Falling out of status is a serious immigration issue because it leads to unlawful presence, which in turn can lead to expulsion from the United States and prohibitions on return. In addition, status violations can prevent a person from extending or changing his or her immigration status and cause denial of future U.S. visas. Once a status violation occurs, each day the foreign national remains in the United States is considered a day of "unlawful presence." Once a foreign national accrues 180 days of unlawful presence, he or she will be barred from re-entering the United States for three full years. A foreign national who accrues a full year or more of unlawful presence faces a 10-year re-entry bar.

Consequently, it is very important that companies be aware of the authorized period of stay granted to nonimmigrant employees and work with immigration counsel to file extensions of stay or amendments in an effective and timely manner. Even a single day of overstay or status violation can have significant negative impacts. It would be unfortunate to lose valuable employees simply due to oversight.

IV. Permanent Residents (Immigrants)

Permanent resident status gives a foreign national **immigrant** classification, which is the permanent right to live and work in the United States as the primary country of residence. Permanent resident status may be obtained through a number of paths. Some paths to permanent resident status are based on family relationships (such as a U.S. citizen spouse, parent, or adult child) and others are based on employment or significant job-creating investments. The primary document used to show permanent resident status is the Form I-551 lawful permanent resident card, commonly referred to as the "green card" due to the original bright green color of the document. Modern "green cards" are issued in a variety of colors, including green, pink, and white, and the design of the card changes frequently. Permanent residents are eligible to work based on their status, so they do not use visas or I-94 Arrival/Departure Records to establish their right to work: The Form I-551 lawful permanent resident card demonstrates their ability to work.

V. United States Citizens

U.S. citizenship can be acquired by birth in the United States or birth outside the United States to at least one parent who is a U.S. citizen. Citizenship can also be acquired through a process called naturalization

in which an individual adopts the principles of the U.S. government and meets other requirements prescribed by law. Naturalization requires a certain period of lawful permanent resident status, usually three or five years depending on the specific circumstances.

C. Common Commercial Nonimmigrant Visa Classifications

Nonimmigrant visas are travel documents issued by the United States Department of State and are issued for a specific period of time, in a particular nonimmigrant category. The visa gives an individual the ability to approach U.S. customs officials at the ports of entry (airports, land crossings, and seaports) for permission to enter. Once Customs grants permission, the I-94 Arrival/Departure Record is created reflecting a specific nonimmigrant classification for a specific period of time (which very often does not match the visa expiration). The various nonimmigrant categories are listed alphabetically in the INA, which is why the category names are a confusing mixture of letters and numbers such as H-1B, L-1A, O-3, F-2, and so on. Set forth below are visa types most commonly used by businesses in the United States.

I. B-1 "Business Visitor" Visa

The B-1 business visitor classification does not allow employment. However, it is used for business activity where (i) the visit to the United States is temporary, (ii) the purpose for entry involves 'business activity' such as meetings, conferences, conventions, presentations, or seminars, (iii) the foreign national will not perform services for the benefit of a U.S. business or be paid from a U.S. source, and (iv) the foreign national maintains a foreign residence that he or she has no intention of abandoning. The length of the period of admission will vary with purpose, need, and expected length of stay, but usually no more than 180 days. 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 that prevent the person from leaving the United States. The B-1 category is heavily scrutinized by customs officials who work to ensure that this classification is not misused for employment. Misuse of the B-1 category can cause loss of the visa for the foreign national as well as potentially permanent re-entry bars. Misuse of this visa category can also result in fines and penalties for employers.

II. ESTA / Visa Waiver

Citizens of specified countries (mainly throughout Europe and the Pacific Rim) are eligible to enter the United States for up to 90 days in B-1 classification without the need to present a B-1 visa. This is known as "visa waiver" or ESTA (Electronic System for Travel Authorization). Although ESTA/visa waiver eliminates the need for a visa, persons who enter in this manner are still required to follow the B-1 rules. Importantly, any violation of the ESTA rules can result in permanent loss of ESTA privileges as well as mandatory return to the home country.

III. TN Status

Sponsoring companies may employ citizens of Canada and Mexico in certain professional positions under the United States-Mexico-Canada Agreement (USMCA, the successor to North American Free Trade Agreement). The TN (Trade NAFTA) application process is more streamlined than for most other nonimmigrant classifications. The basic process requires the foreign national to provide customs with an offer of employment or other engagement by a U.S. employer and evidence of the required educational or work experience background for the particular profession. The profession must be specifically named in the USMCA. Citizens of Canada can apply at any border post or international airport in Canada. Citizens

of Mexico must apply for a TN visa through a U.S. consulate. TN approval is granted only for a specific employer, although there are processes available to transfer a TN from one employer to another.

The TN classification allows admission to the United States for a maximum initial period of three years, which can be extended once more for a total of six years. The TN is considered a strict nonimmigrant category such that it is not permissible to seek lawful permanent resident status. The worker's spouse and children under 21 are eligible to enter in TD (Trade Dependents) 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 U.S. 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 process is complex and requires participation in an annual H-1B lottery, as well as pre-approval from the United States Department of Labor (DOL). The DOL process includes posting a notice at the worksite about the wages that will be paid to the H-1B worker. The required wage targets are set by the DOL as well, and it is a serious violation to fail to pay an H-1B worker the required wage.

An H-1B visa is initially issued for a three-year period and may be extended for an additional three 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 allow the family members to travel with the H-1B employee to the United States. Currently, H-4 spouses are allowed to apply for work authorization, but this rule is subject to change by the current administration.

The E-3 visa available to Australian citizens is virtually identical to the H-1B except that there is no quota and the application can be made directly at the U.S. consular posts in Australia, once the DOL steps are completed.

V. L Intracompany Transferee Visa

The L visa is available to non-U.S. 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 non-U.S. company for a continuous period of one year within the last three years, (ii) have been employed abroad in an executive or managerial position or a position involving "specialized knowledge," and (iii) be coming to the U.S. 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 U.S. 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 three years, except that employees transferring to a new office that has been in operation for less than one year are admitted for only one year. Extensions of stay up to a total of seven years can be obtained for executives or managers and up to five 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 non-U.S. 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 non-U.S. company (treaty country), (ii) citizens or nationals of the treaty country be 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 two 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 U.S. 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 fields 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 three years, with extensions granted in increments of up to three 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 and approvals can be relatively challenging.

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 U.S. 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. The United States has a complex system of annual limits on green cards, including limits for particular categories as well as per-country limits. Each year, demand for green cards exceeds supply, resulting in backlogs and waiting periods for green cards that can last more than 10 years in some cases.

There are two common 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 often qualify for permanent residence.

The second common approach is the labor certification process. Under this approach, before a company can ask USCIS to issue an immigrant visa to an employee, the company must follow strict and complex DOL guidelines to actively recruit to find a qualified U.S. worker for the position. In other words, the law requires that companies test the labor market to determine whether qualified U.S. citizens or permanent residents are available to perform the job. The employer can move forward with the green card process only if DOL certifies that there are no qualified U.S. workers available.

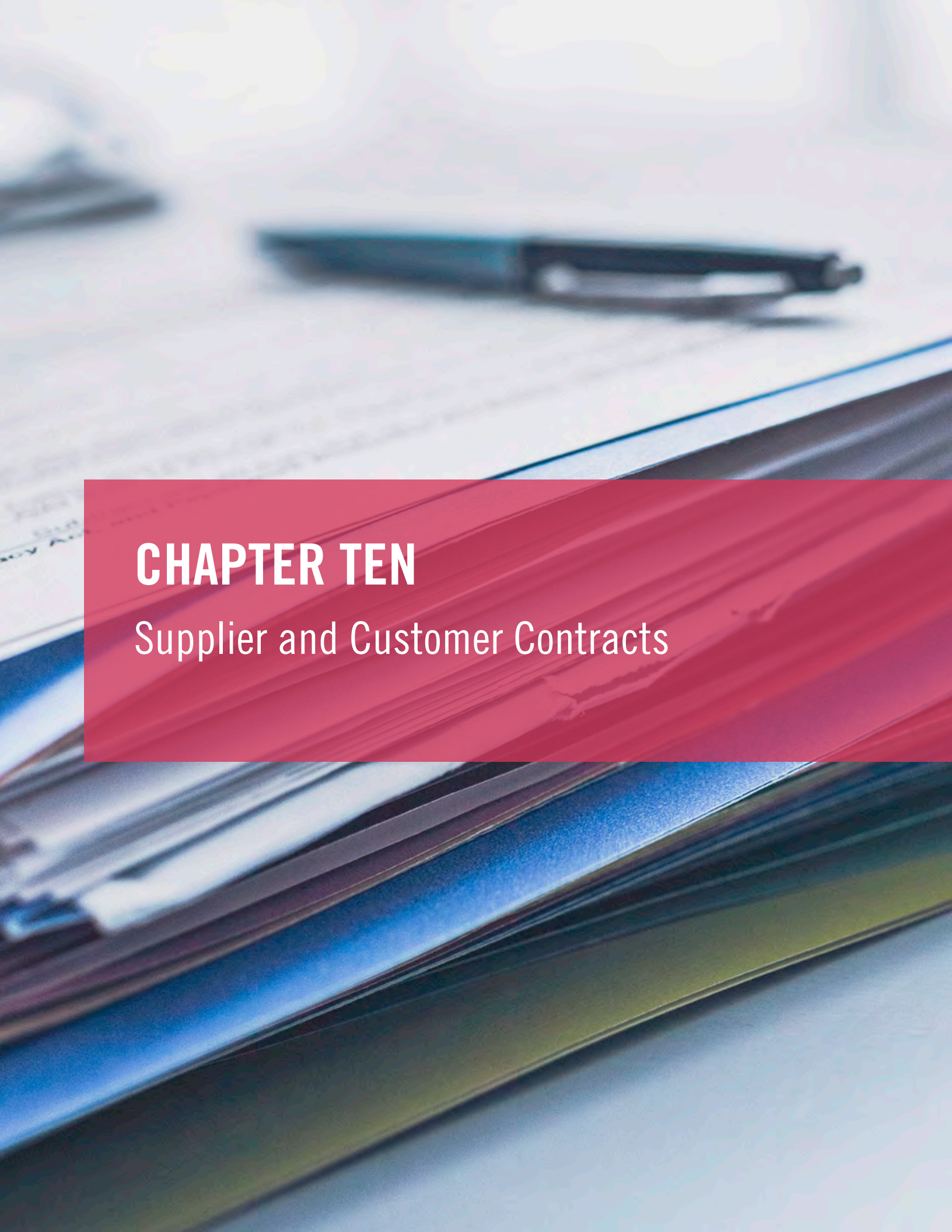
The green card process can be very time-consuming and frequently becomes backlogged and delayed at the DOL and USCIS. Consequently, companies that desire to obtain immigrant status for, and permanently employ, foreign nationals should seek counsel early in the nonimmigrant's stay, rather than waiting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

E. Compliance with Immigration Laws

In 1986, IRCA was enacted by the U.S. 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. The Form I-9 is used for this verification process and must be completed for all hires. Section 1 of the Form I-9 must be completed on the first day of hire by the employee, and Section 2 must be completed within three business days of hire by the employer. Section 1 consists of the employee's personal information, and Section 2 is where the employer must personally inspect and confirm the documents presented by the employee to prove his or her right to work. 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 6 November 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 TEN

Supplier and Customer Contracts

Chapter Ten

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 and duties 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 should describe, at a minimum and 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, although there should be some nexus with the chosen state. Each state would apply statutory law (principally the Uniform Commercial Code as adopted by that state) and its common law. As mentioned in Chapter 1, *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.

If 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 multinational 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 if the parties do not want its application. Otherwise, the CISG will automatically apply to the contract.

For example, if a U.S. 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, including 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 2** 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. Contract Formation

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, the same term may have different meanings depending on whether it is used under the Uniform Commercial Code or under Incoterms (discussed below). In addition, it is unfortunately often assumed that these terms address topics that, in fact, they do not address, such as timing of transfer of title. Consequently, it is important to be clear on the underlying convention being used and to address those issues that are not addressed in order to assure that all delivery particulars are appropriately and adequately 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:

- **FOB** (Free on Board). 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.
- **FAS** (Free Alongside Ship). 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.
- **CIF** (Cost Insurance and Freight). 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" (a shortening of "International Commercial Terms") are a compilation of 11 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; and
- 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 according to the 2020 version, which is the most recent version of Incoterms at the time this Chapter was written:

- **EXW** (Ex Works). Minimum obligations imposed on the seller—make the goods available to the buyer at the seller's premises.
- **FCA** (Free Carrier), **FAS**, and **FOB**. The seller is to transfer the goods to a carrier, free of risk and expense to the buyer.
- **CFR** (Cost and Freight), **CIF**, **CPT** (Carriage Paid To), and **CIP** (Carriage and Insurance Paid To). The seller is to bear certain costs even after the cross over point for assumption of the risk of loss.
- **DAP** (Delivered at Place), **DDU** (Delivered at Place Unloaded), and **DDP** (Delivered Duty Paid). 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 (e.g., FCA applies to any mode of transport, while FOB and FAS are used only for sea transport), (ii) incremental costs/responsibilities (e.g., under DAP, the seller is responsible for unloading, while, under DDU, the buyer is responsible for unloading), 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 generally transfers when the goods are placed on board the ship).

It is important to note that FAS, FOB, CFR, and CIF apply only to sea and inland waterway transport and cannot be used for any other mode of transportation. All of the other Incoterms can be used for any mode of transport. In addition, as noted above, Incoterms do not address various other issues involved in the sale of goods. Most notably, they do not:

- Identify the goods being sold nor list the contract price;
- Reference the method or timing of payment;
- Address when title, or ownership of the goods, passes from the seller to the buyer;
- Specify which documents must be provided by the seller to the buyer to facilitate the customs clearance process at the buyer's country; and
- Address liability for the failure to provide the goods in conformity with the contract of sale or for delayed delivery, nor dispute resolution mechanisms.

Note also 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 (most notably, FOB), 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, complementary 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) specifying 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) obliging the buyer 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 of 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 the contract precisely set forth payment terms and conditions. Basic issues to be covered include (i) procedures for issuing invoices, (ii) when the obligation for payment arises (upon receipt of the invoice or delivery date, for example), (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 (including 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 triggers 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 imposing a requirement that the dispute be submitted to mediation. An independent third party mediator, provided by the American Arbitration Association (AAA), JAMS, 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, and, if the parties have so agreed in the contract, the decision will be binding and enforceable in the courts. 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, JAMS, ICC, or other body).

The advantages 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 3** 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, JAMS, 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.

Some disadvantages of arbitration include:

- The process may not be as cost-efficient or timely as expected.
- The decision of the arbitrators cannot be appealed, except under very limited circumstances.
- There typically is no public record of an arbitral award, so the decision may have no deterrent effect on future wrong-doers.

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 U.S. court system, *see* Chapter 1, *Operations in the United States*.

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 disclaimed. Sellers frequently disclaim (in conspicuous writing) the implied warranties of merchantability and fitness for a particular purpose, which, absent an express disclaimer, will be imposed by applicable law, 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 attempting to exclude indirect, incidental, consequential, punitive, exemplary and similar damages. 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. Care must be taken in negotiating exclusions of these types of damages as their exclusion may result in limited practical remedies. Unfortunately, “consequential” damages, in particular, has been given a connotation that is beyond its true legal meaning. As such, careful attention must be given to its negotiation to ensure that the results will be in line with the intent of the parties.

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, pandemics 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 ELEVEN

United States Businesses Acquisitions

Chapter Eleven

UNITED STATES BUSINESS ACQUISITIONS

In deciding whether to make a significant investment in the United States, a non-U.S. 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 non-U.S. 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 2, *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 2**. For a discussion of joint ventures, *see* Chapter 12, *United States Joint Ventures*. This Chapter will discuss acquisitions of businesses operating in the United States.

The acquisition of a U.S. company (Target Company) by a non-U.S. company or by a subsidiary entity owned by a non-U.S. 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 8, *Employment Law (Federal and State)*, which discusses mandatory notices under the Worker Adjustment and Retraining Notification Act (WARN).

Note also that a flow chart laying out the general process for the acquisition of a U.S. 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 U.S. 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, information technology and data privacy, environmental and workplace safety issues, labor and employee benefit matters, tax matters, regulatory 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.

The level of diligence efforts will also be dependent on whether the Buyer opts to obtain representations and warranties insurance (RWI). Sellers of a United States Target Company routinely request buyers to obtain RWI in connection with a transaction, and many sellers require bidders to agree to RWI as a condition to participating in a competitive sell-side auction. Sellers prefer RWI as it allows sellers to minimize their post-closing liabilities by creating a third party protection mechanism that permits the parties to drastically reduce or eliminate the seller's indemnification obligations. RWI in the United States is very similar to representations and warranties insurance that can be obtained by buyers in Europe, though there are several key differences. If the Buyer intends to obtain RWI for a transaction, the Buyer's diligence efforts must ultimately satisfy the insurer, which may require the Buyer to conduct a more detailed diligence review than it may have otherwise undertaken. In addition, RWI insurers often request the ability to review diligence reports created by the Buyer and to conduct diligence calls with the Buyer and its representatives on diligence efforts taken. If the Buyer did not perform diligence in any particular subject matter to the satisfaction of the RWI insurer, the insurer may exclude such subject matter from coverage under the RWI. In addition, RWI insurers will exclude from coverage any known issues.

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. Please note that, while "locked box" purchase price mechanisms remain popular in many countries, Target Companies in the United States are more familiar with the working capital adjustments to purchase price. 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:

- The title to and condition of the assets and properties;
- Existence of litigation;
- Accuracy of financial statements and the absence of liabilities not included in the financial statements;
- Status of customer and supplier relations and related material contracts;
- Authority to conclude the transaction;
- Absence of conflicts;
- Status of employee relations and employee benefit plans;
- Protection of intellectual property and data privacy;
- Violations of laws; and
- 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 serve these purposes:

- Bring to light potential liabilities and problems associated with the business;
- Confirm exactly what is being purchased;
- 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);
- Force the Target Company (or its shareholders) to think carefully about all aspects of its business;
- Provide a basis for imposition of indemnification liability (see discussion below); and
- 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. In addition, it has become customary in the United States for the Buyer to disclaim reliance on any information or materials made available by the Target Company or its sellers in diligence unless it is covered by representations and warranties in the acquisition agreement. Such disclaimer may prevent the Buyer from obtaining any remedy with respect to a claim that information provided in diligence (for which there is no representation or warranty in the acquisition agreement) was incorrect. As such, the Buyer should ensure that the representations and warranties in the acquisition agreement cover all matters that may be important to the business of the Target Company.

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:

- Restrictions on the Target Company's operation of the business, other than in the ordinary course of business;

- Cooperation in completing any remaining due diligence and in seeking consents and approvals (including antitrust approvals) to the transaction;
- Cooperation with the Buyer in finalizing the terms of any financing that the Buyer may need for the transaction; and
- 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:

- Non-competition or non-solicitation obligations (to prevent the Target Company or selling shareholders from competing with the Buyer in the same business that it just sold or to solicit the employees or customers of such business);
- Confidentiality requirements;
- Tax return procedures for any periods that straddle the closing date; and
- 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 approvals from antitrust authorities and consents from any landlords and licensors), (iii) delivery of other agreements (such as employment agreements from key employees, escrow agreements, restrictive covenant 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 and the stock is certificated).

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

For acquisitions of private Target Companies in the United States, an acquisition agreement will likely include an indemnification section, which provides the responsibilities and certain 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 acquired business. 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. If, however, the Buyer has agreed to obtain RWI, an acquisition agreement may not have any indemnity provisions, which would require the Buyer to rely exclusively on the RWI as protection for the transaction, or it may include only a limited indemnity provision having a cap based on the deductible under the RWI.

IX. Miscellaneous

This category addresses miscellaneous matters such as notice arrangements, governing laws, procedures for modification of the agreement, methods for resolving disputes, waivers of conflicts to permit sellers' counsel to continue representing such sellers (even though such counsel may also have represented the Target Company in the transaction), and allocation of rights with respect to attorney-client privileges that the Target Company may have regarding work product or communication from such counsel in connection with the transaction. 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 percent 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 to assignment 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 U.S. 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 or other circumstances that should be addressed with U.S. tax counsel).

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 U.S. 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 U.S. 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 transfer taxes or 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 and report form and observe a waiting period if the acquisition meets certain size and jurisdictional thresholds. In addition, the acquiring party is responsible for the payment of a filing fee ranging from US$45,000 to US$280,000, depending upon the size of the transaction. The purposes of the HSR Act are (i) to permit the regulating federal agencies, the Federal Trade Commission (FTC) and United States 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." It is noteworthy that the HSR Act is a notice process and not an approval process; at the end of the 30-day waiting period, the transaction may close unless either the FTC or DOJ have taken steps to either toll the waiting period or prevent the acquisition altogether.

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. An HSR filing is generally required in the United States for a proposed acquisition whenever the following threshold criteria are met:

- The target entities or assets have sufficient sales in, from, or into the United States, or assets located in the United States; **and** either
    - The transaction is valued at more than US$368 million; or
    - The transaction is valued at more than US$92 million, but not more than US$368 million; and
        - One of the parties has total assets or annual net sales of US$184 million or more, and
        - The other person has total assets or annual net sales (total assets only for the seller if not a manufacturer) of US$18.4 million or more.

Note that the above amounts, effective as of 4 March 2021, are revised each year based on the percentage change in the U.S. gross national product.

Analysis of the applicability of the HSR Act is complicated, since several exemptions may apply and results may depend upon whether the Target Company is a corporation, limited liability company or partnership and whether the acquisition is one of stock or assets.

If a transaction is reportable under the HSR Act, the subject parties must separately fill out a notification and report form. Depending on the nature of the acquisition, completion of the forms may take between eight and 160 hours (according to the instructions). Once the parties' forms have been filed with the FTC and the DOJ and the appropriate filing fee has been paid, the 30-day waiting period commences in which the FTC and the DOJ analyze the transaction (in certain unusual circumstances, the waiting period may be shorter than 30 days). During this period, the parties may not consummate the transaction, and the Buyer must not undertake any activities that could be viewed as establishing beneficial ownership or control of the Target Company or assets. 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 then close 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 over US$43,000 (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)

CFIUS is an inter-agency committee chaired by the Secretary of the Treasury with broad authority to review non-U.S. investments and acquisitions in the United States for national security concerns. The parties to a transaction can notify CFIUS of the transaction and request review, or CFIUS can initiate a review on its own authority, including of completed transactions. If CFIUS conducts a review and does not identify any national security concerns with a transaction, it will provide the parties with clearance, which is a safe harbor against future review of the same transaction. Where CFIUS identifies a national security concern associated with a transaction, it may require the implementation of mitigation measures or alteration of the deal structure to eliminate the concern. If the national security concern cannot be adequately mitigated, CFIUS can require that the transaction be modified or even blocked. If the transaction has already been completed, CFIUS can order divestment of acquired U.S. businesses and assets where necessary to safeguard national security. There is no time limit for CFIUS's lookback on completed transactions that were not previously reviewed and cleared.

CFIUS has a very broad remit to determine its own jurisdiction, and undertakes review of issues that fall outside the defense- and intelligence-related issues that the public commonly considers to be U.S. national security. For example, CFIUS may consider the impact of a transaction on development and use of U.S. "critical technologies," which include not only sensitive technologies currently subject to export licensing controls, but also emerging and foundational technologies that may impact national security. Critical U.S. infrastructure is also examined, which may include transportation networks and infrastructure, energy generation, storage and transmission assets, telecommunications networks, and financial and banking systems. Also, in response to significant data breaches affecting the U.S. government, CFIUS closely examines the impact of transactions on U.S. personal data security, especially where the non-U.S. acquirer or investor is subject to control by a country that has not implemented robust data protection laws. This may impact transactions involving social media, health care providers, insurance companies, and financial institutions. Other issues may be of concern, such as food and drug safety, and, as noted below, CFIUS now has the ability to review real estate acquisitions that are not tied to the acquisition of a U.S. business. Because of the difficulty in defining CFIUS's precise

scope of review, as well as risk of review long after transaction closing, CFIUS has become one of the prime regulatory concerns for non-U.S. parties contemplating acquisitions and investments in the United States.

As a result of significant reforms under the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), CFIUS review covers the following transactions, collectively termed “covered transactions”: (i) “covered control transactions,” which are transactions that could result in control of a U.S. business directly or indirectly by a non-U.S. person (whether or not that control is actually exercised, including transfers of a U.S. business from one non-U.S. person to another); (ii) “covered investments,” which are certain non-controlling investments in certain U.S. businesses (a TID U.S. business (“TID” stands for technology, infrastructure, and data)) that afford a non-U.S. person access to material nonpublic technical information, board membership or observer rights, or substantive decision-making authority regarding critical technologies, critical infrastructure, or sensitive personal data; (iii) changes in rights that give a non-U.S. person control over a U.S. business; (iv) transactions designed or structured to evade CFIUS jurisdiction; and (v) certain acquisitions, leases, and concessions involving real estate that is proximate to identified sensitive U.S. military installations.

Except as described below, seeking CFIUS review of a covered transaction is voluntary. However, given CFIUS’s broad jurisdiction to review non-notified transactions, parties concerned about CFIUS risk can notify CFIUS of the transaction prior to closing and seek safe harbor clearance. For transactions involving a low risk of the existence of national security concerns, parties can reasonably make a decision to proceed with the transaction without submitting a notice to CFIUS, with the understanding that CFIUS would have jurisdiction to review the transaction in the future, should a review be deemed necessary.

Parties must, however, notify CFIUS in two situations: (i) certain covered transactions that involve a TID U.S. business that produces, designs, tests, manufactures, fabricates, or develops certain “critical technologies” and a non-U.S. person receiving certain elements of control, or (ii) covered transactions that would result in an entity in which a non-U.S. government has a substantial interest (defined as 49 percent or greater) obtaining a substantial interest (defined as 25 percent or greater) in a TID U.S. business. The failure to submit a required notice can result in penalties of up to the value of the relevant transaction.

In considering whether to file a notice with CFIUS, the transaction parties should examine several key factors to determine whether the transaction raises any potential national security concerns such that a notice to CFIUS is either advisable or required. These key factors include the amount of control over the U.S. business that the non-U.S. person would acquire; the identity of the non-U.S. person; whether the business deals with critical technologies, critical infrastructure, or sensitive personal data of U.S. citizens; whether the business includes locations that are within a close proximity to sensitive U.S. military installations; whether the business has sensitive U.S. government contracts; and whether the business is a sole supplier to a critical industry. Because CFIUS weighs the national security vulnerability of the U.S. target against the threat posed by the non-U.S. acquirer or investor, parties should also consider the identity of the non-U.S. party, including country of establishment, countries of intermediate and ultimate shareholders, and any non-U.S. government connections either through direct or indirect shareholding or governmental influence through key management and director positions.

FIRRMA also provided CFIUS with jurisdiction to review certain purchases or leases by, or concessions to, a non-U.S. person of real estate in the United States that fall outside the scope of a “covered

transaction" involving a U.S. business, discussed previously. CFIUS jurisdiction in particular applies to certain acquisitions, leases, and concessions of real estate that are (i) within or that operate as part of certain U.S. maritime ports or airports, (ii) within a defined proximity range of identified critical U.S. military and intelligence facilities, or (iii) within certain offshore U.S. military zones. Although no mandatory filing is required, parties to transactions that involve real estate that falls under CFIUS's real estate jurisdiction may want to consider filing a notice with CFIUS to confirm that no unresolved national security concerns exist.

In notifying CFIUS of a transaction, parties can file either a short-form declaration or a long-form joint voluntary notice (JVN). The declaration provides an overview of the proposed transaction and information about the U.S. business and non-U.S. person purchaser. There is no filing fee for the declaration. Once filed and accepted, CFIUS has 30 days to review the content of the declaration and ask questions of the parties. After the 30 days, CFIUS can either (i) request that the parties file a JVN, (ii) inform the parties that it was not able to conclude its review but is *not* requesting that the parties file a JVN, (iii) initiate a unilateral review of the transaction, or (iv) notify the parties that it has concluded all action with respect to the transaction. If CFIUS informs the parties that it was not able to conclude its review but is not requesting that the parties file a JVN, the parties can proceed with closing the transaction but without the benefit of receiving CFIUS safe harbor clearance.

The JVN is substantially longer than the declaration and requires disclosure of significant information about the non-U.S. person and its direct and indirect shareholders, including personal identifier information of certain officers and directors. As a result of FIRRMA, submission of a JVN requires a filing fee that is based on the value of the transaction (currently the maximum fee is US$300,000). Once the JVN has been filed and accepted, CFIUS has 45 days to conduct its initial national security review. If CFIUS concludes that there are no unresolved national security concerns with the transaction, CFIUS will conclude its review and provide safe harbor clearance to the transaction parties. If, however, there are unresolved national security concerns, or if required by law (for example, certain transactions involving a non-U.S. government-controlled acquirer), CFIUS will extend the proceeding into a further 45-day investigation, which can be extended a further 15 days. If there are no unresolved national security concerns at the end of this period, CFIUS will conclude its review and provide safe harbor clearance. If, however, not all national security concerns have been mitigated and the parties have not voluntarily abandoned the transaction, CFIUS may refer the matter to the president of the United States, who has 15 days to review CFIUS's recommended course of action. The president may then exercise powers to modify or block the transaction or require divestiture if the transaction has already closed.

During its proceeding, CFIUS may request mitigation measures to alleviate identified national security concerns. Examples of mitigation measures may include restrictions on access to non-public intellectual property or sensitive personal data of U.S. citizens; implementation of guidelines or terms for entering into U.S. government contracts; establishing security and access protocols; requiring that sensitive operations be placed into a proxy entity under the control of U.S. citizens; as well as divestiture of part or all of the U.S. business.

By law, the entire CFIUS process, including identities of the parties and any information they provide CFIUS as part of or in preparation for a proceeding, is confidential and not subject to disclosure under the U.S. Freedom of Information Act (FOIA). Only presidential orders to modify or block transactions as discussed above are publicly disclosed.

Experienced CFIUS counsel should be consulted on the CFIUS process, who can advise on the applicability of CFIUS jurisdiction and the mandatory notification requirement, the likely national security concerns, the risks of proceeding without notification, as well as whether a declaration versus a JVN should be filed. For transactions likely to present national security risks, experienced counsel can also help devise deal structure alternatives and mitigation measures. In some cases, it may be advantageous to anticipate these issues and propose mitigation measures to CFIUS at the outset of a proceeding.

G. Reporting Requirements for Foreign Direct Investment

Under the International Investment and Trade in Services Survey Act, non-U.S. entities directly or indirectly acquiring 10 percent or more of the voting interest of certain U.S. business enterprises (and certain U.S. real estate) must report that acquisition and make periodic filings to the Bureau of Economic Analysis of the U.S. 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); and
- 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 percent or more interest in a U.S. business enterprise that has total assets of more than US$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 U.S. business enterprise, investment incentives, the non-U.S. 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 percent of a U.S. business enterprise is owned by a non-U.S. company at any time during the quarter and any of (i) total assets, (ii) gross operating revenues, or (iii) annual net income of that enterprise exceeds US$30,000,000. That form contains information relating to direct financial transactions between the U.S. affiliate and its non-U.S. 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 31 May of each year, updating financial and operating data of U.S. 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 website, **www.bea.gov/surveys/fdiusurv**. 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 Affecting Acquisitions by Non-U.S. Persons

There are various U.S. export control and other non-U.S. policy and national security related regulations and administrative programs that, although not specifically providing for the review of non-U.S. acquisitions in the United States, nonetheless can materially affect the feasibility or desirability of such an

acquisition or the process for completing it. The following is a brief overview of these regulations and administrative programs. In addition, depending on the industry and nature of the acquisition, other industry-specific regulatory considerations also may come into play.

I. U.S. Export Controls - EAR and ITAR

The International Traffic in Arms Regulations (ITAR), administered by the U.S. Department of State's Directorate of Defense Trade Controls (DDTC), govern certain items and services with military applications, which are defined as defense articles and related technical data and defense services. The ITAR prohibits the export and the release of defense articles and related technical data and the furnishing of defense services to non-U.S. persons without a license or authorization. Additionally, U.S. individuals and entities involved in the manufacturing, exporting, or brokering of defense articles and the furnishing of defense services must register with DDTC.

Dual-use and commercial commodities, software, and technology not controlled under the ITAR are generally subject to the Export Administration Regulations (EAR), which are administered by the U.S. Department of Commerce's Bureau of Industry and Security. (Certain commercial nuclear items and technology may be separately subject to exclusive export control enforcement jurisdiction of the Nuclear Regulatory Commission and the Department of Energy.) The EAR controls the export, re-export, and transfer (including in-country transfer) of commodities, software, and technology to certain destinations, end users, and end uses. Unlike the ITAR, there is no registration requirement under EAR.

Notably, under the ITAR and the EAR, releases of technical data to non-U.S. persons, such as through visual inspection, constitutes an export to the non-U.S. person's home country, even if the non-U.S. person is physically located in the United States.

The ITAR and the EAR would be relevant to a proposed acquisition of a U.S. business in the following circumstances:

- To the extent that due diligence by the non-U.S. investor requires access to controlled technology, export authorization may be required to conduct such due diligence.
- If the acquisition involves an ITAR-registered business, the registrant must notify DDTC of the intended acquisition by a non-U.S. person at least 60 days in advance of closing. The notification provides DDTC with an opportunity to require approval of the transfer of ITAR-controlled items to the purchaser (a requirement that is ordinarily not 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. Within five days of closing, the U.S. business must update its ITAR registration to reflect the new ownership (whether non-U.S. or domestic) and provide relevant ownership information.
- To the extent that existing licenses or approvals held by the U.S. 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 U.S. business activities post-acquisition.
- To the extent that the U.S. business to be acquired has technology subject to export controls, access to the technology by, or any transfer of the technology to, the non-U.S. 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 U.S. government, which imposes significant penalties for compliance failures. The penalties and other consequences for compliance failures generally are considered to continue through successor liability principles with the business that is acquired. Accordingly, it is critical to assess any possible past or ongoing compliance failures as part of the acquisition due diligence process.

II. U.S. Trade Embargoes - OFAC Regulations

The United States currently maintains a number of economic sanctions programs, which are principally administered by the United States Department of the Treasury's Office of Foreign Assets Control (OFAC). Sanctions can be comprehensive or selective and against countries, individuals, or entities for a variety of foreign policy and national security reasons, such as terrorism, cyberattacks, and nuclear proliferation. The countries and regions that are currently subject to comprehensive embargo type restrictions are Cuba, Iran, North Korea, Syria, and the Crimea region of Ukraine. Individuals and entities subject to comprehensive sanctions restrictions are identified on various restricted party lists maintained by different U.S. government agencies, most prominently OFAC's Specially Designated Nationals and Blocked Persons List.

Sanctions restrictions can be relevant to acquisitions by non-U.S. persons in the United States in a number of ways. First, generally, the restrictions would bar any restricted party from lawfully engaging in investment activities in the United States or involving the U.S. financial system, and attempts by a U.S. business to engage in investment transactions with restricted parties could constitute a violation of sanctions laws and regulations. Second, to the extent that the non-U.S. person proposing to make an investment in the United States engages in trade outside the United States involving countries or persons subject to the sanctions restrictions, it is important for the non-U.S. investor to evaluate any risks and needed compliance undertakings that may result from the investment even though the investment may not result in those activities being barred. Third, as with export control laws discussed above, sanctions compliance failures can result in significant penalties and can continue with the acquired business through successor liability principles. It is therefore critical to assess any possible past or ongoing compliance failures as part of the acquisition due diligence process.

III. Government Contract / Security Clearances

If the U.S. business is engaged in work requiring a United States Department of Defense or other federal government security clearance, the business cannot be subject to foreign ownership, control, or influence. If a non-U.S. person is contemplating acquiring or investing in a U.S. business with a security clearance, the non-U.S. person should be prepared to be subject to mitigation measures if the business intends to maintain its security clearance. Arrangements to maintain the business's clearance must be resolved in advance of the acquisition through a notification to and commitment letter with the Defense Counterintelligence and Security Agency (DCSA). DCSA works with the U.S. business to determine the appropriate form of mitigation, which could include hiring of independent directors to handle prerogatives of ownership related to cleared work or a proxy agreement whereby proxy holders exercise all prerogatives of ownership and have the freedom to act independently from the non-U.S. acquirer or investor, with certain exceptions.

Additionally, legislative initiatives periodically seek to disqualify or put at a disadvantage U.S. businesses owned by non-U.S. persons in competing for at least certain types of U.S. 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 also should 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 non-U.S. 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 non-U.S. nationals in the business after the acquisition will also need to be analyzed. Since the terror attacks of 11 September 2001, the U.S. 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 U.S. immigration laws, *see* Chapter 9, *Immigration Law*.

CHAPTER TWELVE

United States Joint Ventures

Chapter Twelve

UNITED STATES JOINT VENTURES

A. Joint Ventures in the United States

Domestic and non-domestic parties use joint ventures to become more competitive and to promote the development, manufacture, assembly, distribution, and sale of components, products, technology, and services in the United States and around the world. In the past, it was common for joint ventures to be relatively self-contained business units that could be bought and sold separately from the joint venture participants. However, today's joint ventures are almost never fully self-contained business units, and can rarely be separated from the participants without some difficulty or pre-planned disassembly. In addition, today's joint ventures usually provide different benefits to each of the participants (as seen, for example, in a joint venture between a company selling batteries and an automobile company selling battery powered cars) and therefore are not as easily severable from the parties as are self-contained businesses.

Joint ventures in the United States are usually complex. Many cross-border parties approach joint ventures with a combination of enthusiasm and overconfidence, but the parties often underestimate the complexity and risks of forming and closing joint venture transactions. Joint ventures that cross one or more borders (especially multi-entity joint ventures that operate in the United States and multiple other countries) can be exceedingly challenging to structure, and require many months of tax, accounting, and regulatory analysis from experts in every country touched by the joint venture. Joint venture transactions between U.S. and non-U.S. parties should be approached and vetted with great care and given the time they need to develop.

The United States has an extensive, sophisticated legal system at the federal and state levels, with many laws (including potentially the laws of more than one state) that apply to joint venture transactions. U.S. businesses are accustomed to receiving commercial advice from large, sophisticated law firms and to heavily documenting transactions, especially for public companies where senior managers must be able to justify their decisions to a variety of constituents. These factors will influence creation of joint ventures.

Failure rates of joint ventures are high and disputes can end up in the U.S. court system, which can be unforgiving to the joint venture participants. Planning for exits at the time of formation of the joint venture constitutes best practice in the United States.

B. Appropriate Legal Entity

For a non-U.S. joint venture participant, structuring joint ventures in the United States involves at least two fundamental steps. The first step is determining how the non-U.S. entity will engage in business in the United States. The second step is determining what type of entity will be used for the joint venture, including the tax and regulatory consequences for the non-U.S. joint venture participant in its home country.

In some countries, a separate form of legal entity is used for a joint venture. However, in the United States, there is no form of legal entity called a "joint venture." With very limited exceptions, such as "joint

venture" characterizations of certain business relationships in federal regulations applicable to doing business with the U.S. government, the term "joint venture" is a business colloquial term in the United States that has little or no legal significance.

As discussed in Chapter 2, *Entity Selection*, one of the most important decisions to be made by a non-U.S. joint venture participant establishing business operations in the United States is the selection of a type of business entity. Corporations and limited liability companies are the types of business entities that are most frequently used for joint ventures. *See* Chapter 3, *Corporation Formation and Operation*, and Chapter 4, *Limited Liability Company Formation and Operation*, for more information on the formation and operation of corporations and limited liability companies.

Because of U.S. tax issues, very few non-U.S. entities hold direct ownership interests in U.S. property or businesses. Instead, most non-U.S. entities hold ownership of their U.S. business concerns through a U.S. holding company established for that sole purpose. The holding company can own the interests in a joint venture directly, or through a separately created subsidiary entity of the holding company formed for that purpose. The subsidiary entity, in turn, could be a corporation or a limited liability company, since for U.S. taxation purposes, tax reporting for the holding company would most likely be consolidated with the holding company's wholly-owned subsidiaries. The determination of how a non-U.S. entity will engage in business in the United States is a tax analysis dependent in part on the tax treaties between the United States and the country in which the non-U.S. entity is domiciled or the other countries that are affected by the joint venture's business. *See* Chapter 2, *Entity Selection*, and Chapter 5, *Taxation of United States Operations*.

C. State of Formation

Each state in the United States has its own laws governing the formation of business entities. The majority of corporations and limited liability companies used by non-U.S. parties that are participating in a U.S. joint venture are formed in the state of Delaware. Delaware has a very sophisticated business court with many experienced judges and the most substantial body of business-based case law in the United States. However, parties sometimes form the joint venture entity under the laws of another state of the United States if a joint venture party is already domiciled in that state, or if there is another specific reason to form in that other state.

The state that is selected to form the joint venture entity does not have to be the same state where the joint venture engages in business. The joint venture entity, wherever it is formed, will have the right to register to do business in any or all 50 states of the United States. The rules for when an entity needs to register to do business in another state of the United States vary from state to state, but many states require qualification if a business is present in the state for a period of 30 days or more, or has consistent and regular contacts with the state. For example, it is very common to form a corporation or limited liability company in the state of Delaware as the joint venture entity, and then register to do business in another state or states where the joint venture business would be operated. *See* Chapter 6, *Regulation of Non-U.S. Companies*.

D. Joint Venture Documentation

The documentation for formation and governance of joint ventures in the United States consists of documents that are required by state statute (such as certificates of incorporation or limited liability company agreements), as well as additional documentation that addresses other rights and obligations of

the parties (such as the management and governance structure, rights of first refusal, drag-along rights, tag along rights, registration rights, and contribution obligations). Statutory and case law may impose certain limits on the provisions that the parties can agree to, such as restrictions on distributions that impair payments to creditors, and restrictions on waivers of certain fiduciary duties. The formation and governance documentation will be governed by the law of the state in which the joint venture entity is formed.

In addition, joint ventures usually also have commercial contracts, such as license agreements, manufacturing agreements, supply agreements, sales agreements, and service agreements. These commercial contracts can be governed by the laws of any state agreed between the parties, and they do not have to be governed by the law of the state in which the joint venture entity is formed.

E. Dispute Resolution

Dispute resolution provisions for joint ventures in the United States must be carefully determined. Parties that are located outside of the United States usually want to avoid litigation in U.S. courts. Unless a form of alternative dispute resolution is agreed upon by the parties in the joint venture documentation, the default dispute resolution path will be litigation in U.S. courts. Alternative dispute resolutions (mediation and arbitration) can use tribunals based in the United States (such as the American Arbitration Association or JAMS), or outside the United States (such as the International Court of Arbitration of the International Chamber of Commerce, the London Court of International Arbitration, the International Centre for Dispute Resolution, the Hong Kong International Arbitration Centre, and the Singapore International Arbitration Centre).

F. Regulatory Matters

The Hart-Scott-Rodino Antitrust Improvements Act (HSR Act) applies to joint venture formation. *See* Chapter 6, *Regulation of Non-U.S. Companies.* As a result, a HSR Act specialist should be consulted to determine if a HSR filing is required. The Committee on Foreign Investment in the United States (CFIUS) also has jurisdiction over joint ventures formed in the United States, and a filing with CFIUS may be needed. *See* Chapter 6, *Regulation of Non-U.S. Companies.* In addition, the other regulations discussed in Chapter 6, *Regulation of Non-U.S. Companies* should be considered by a non-U.S. party when forming a joint venture in the United States.

CHAPTER THIRTEEN

Customs, Duties, and Tariffs

Chapter Thirteen

CUSTOMS, DUTIES, AND TARIFFS

A. Introduction

Customs laws are designed to serve various governmental policy objectives. By imposing controls 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 consumer products that have not received required approvals), prohibit the entry of contraband and items that may violate U.S. patents and trademark rights, and enforce remedies against unfair trade and product-specific protections such as anti-dumping, anti-subsidy, safeguards laws, and trade retaliatory measures under Section 301 of the Trade Act of 1974. The United States Department of Homeland Security is charged with, among other things, administering and enforcing customs laws and regulations, which it does primarily through two agencies, U.S. Customs and Border Protection (CBP) and U.S. 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 trade treaties such as the United States-Mexico-Canada Free Trade Agreement (USMCA), bi-lateral trade agreements between the United States and multiple other countries, including Chile, Israel, Jordan, and South Korea, and multilateral agreements under the World Trade Organization (WTO) are integral parts of that regulatory system. Due to long-term reductions in tariffs under the WTO and the preceding General Agreement on Tariffs and Trade (GATT), duties on many items have been reduced to zero or near zero. However, certain items may still be subject to significant duties.

The U.S. importer (the importer of record) bears the responsibility for declaring the valuation, classification, and rate of duty for goods entering the United States, all of which are subject to review and acceptance by 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 must conduct their businesses 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, because failure to do so may result in detention or seizure of goods, as well as civil and criminal penalties. CBP routinely imposes civil penalties for misstatements made in connection with entering merchandise, including as to value and classification of the merchandise.

B. Customs Laws and Procedures

Generally speaking, the steps for importation into the United States of goods 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. There are special requirements when a non-resident acts as the importer.

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 U.S. 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 are to determine (i) whether the goods have been properly classified under the Harmonized Tariff Schedule of the United States, (ii) the value of the goods for customs purposes and their dutiable status, (iii) whether the goods are properly marked with the country of origin and have been correctly invoiced, (iv) whether the shipment contains prohibited articles, and (v) whether the goods listed on the invoice match those actually shipped. Most shipments clear customs in a "paperless" manner with the entry information being electronically processed through the customs system.

Other U.S. 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:

- Food products, drugs, and cosmetics (the Food and Drug Administration);
- Agricultural commodities (the Department of Agriculture);
- Alcohol, tobacco, firearms, and explosives (the Bureau of Alcohol, Tobacco, Firearms and Explosives); and
- 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 an overview of OFAC and its sanctions and embargo programs, *see* Chapter 11, *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 the entry, including 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 any 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 USMCA, lower rates apply to certain goods that originated within Mexico, Canada, or the United States.

C. 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 U.S. federal and state laws.

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

D. United States-Mexico-Canada Free Trade Agreement

The USMCA, a successor agreement to the North American Free Trade Agreement (NAFTA) that became effective 1 July 2020, establishes a free trade area between each of the United States, Canada, and Mexico. The primary goals of the USMCA are to:

- Eliminate tariffs completely on goods qualifying as originating in USMCA countries;
- Remove non-tariff barriers, such as import licenses;
- Increase investment opportunities;
- Provide protection and enforcement of intellectual property; and
- Create effective administrative and resolution procedures.

In order to qualify for preferential duty rates under the USMCA, a good must satisfy the USMCA rules of origin. Under the prior, NAFTA arrangement, a certificate of origin issued by the exporter generally was required for goods to be qualified as originating within the United States, Canada, or Mexico; under the USMCA, the producer, exporter, or importer can issue an origin certification, which must be maintained by the importer. Under the rules of origin, transshipments generally will not qualify for USMCA treatment. For example, goods made in Brazil but shipped through Mexico will not qualify for preferential USMCA duty rates when imported into the United States. In certain circumstances, however, a non-originating good may qualify for USMCA treatment.

Although the USMCA 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.

E. General Agreement on Tariffs and Trade and the World Trade Organization

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; and
- Non-discriminatory administration of quantitative restrictions.

In 1994, GATT was reformed after the Uruguay Round, and WTO was established in 1995 to oversee the administration of GATT, the General Agreement on Trade in Services and Trade-Related Aspects on Intellectual Property Rights. 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 percent 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, duties, or other restrictions.

F. Trade Remedies Laws

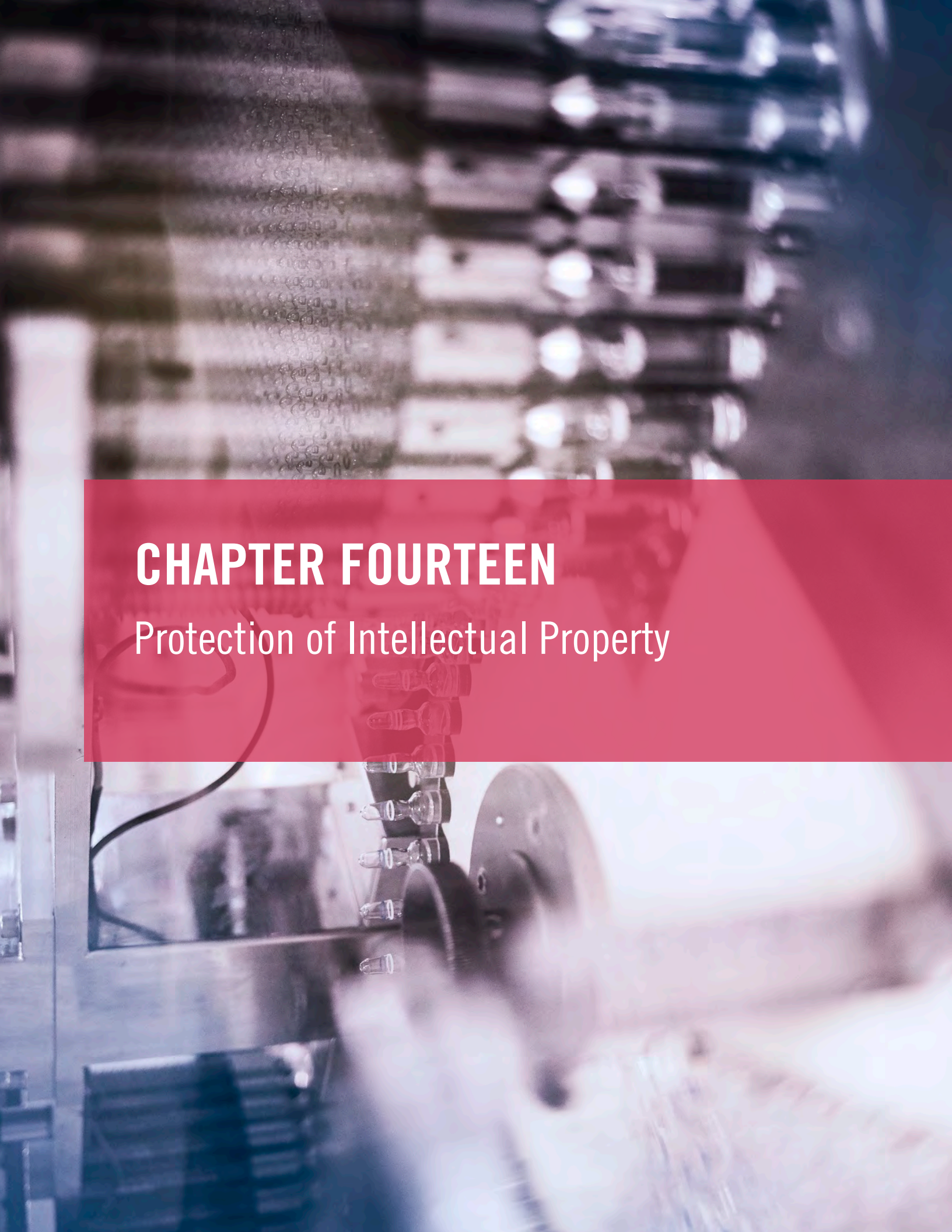
The United States enforces an array of laws that target and counteract unfair practices among U.S. trade partners, the primary measures being anti-dumping (AD) and anti-subsidy / countervailing duty (CVD) laws. AD / CVD laws target imports of specific classes of products from specific countries. Duties imposed under AD / CVD laws can be very substantial, even exceeding the value of the subject imported goods. Moreover, duties when paid upon entry are merely “estimated” duties subject to future annual review of the underlying AD / CVD order. Depending upon the results of a future review, the final duty rate may be different. If the final duties are higher, the importer must deposit those additional amounts, plus interest, but, if the duties are lower, then a refund of excess duties, plus interest, will be returned to the importer. In addition, special duties may be imposed under a number of other trade remedies laws, including for national security reasons.

G. 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. The use of import quotas was largely banned under the WTO. However, quotas are still permitted for limited commodities, and in some cases the United States may unilaterally impose quotas in some situations. Products that have been subject to quota recently include certain sugar, cheeses, steel, and aluminum.

Import quotas may be 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 may be 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.



CHAPTER FOURTEEN

Protection of Intellectual Property

Chapter Fourteen

PROTECTION OF INTELLECTUAL PROPERTY

A. Introduction

In many cases, the intellectual property of a non-U.S. company constitutes some of its most valuable assets. Whether intellectual property is licensed or used by a non-U.S. 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. Patents

I. 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 exclude others from making, using, offering for sale, selling, and importing in the United States an invention that is covered by the patent. Although a U.S. 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 non-U.S. competitor from using the invention in another country and selling the product in other countries (unless protection has been obtained by the inventor in those other countries).

Correspondingly, even though a non-U.S. 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 other 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 U.S. Patent and Trademark Office (USPTO). For an invention to be patentable in the United States, it must be all of the following:

- Patentable subject matter, including being useful and not one of the recognized exceptions;
- Novel; and
- 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, or (v) any improvement of the foregoing. A patentable invention also must have practical utility. Importantly, certain subject matter is not patent eligible in the United States even if it satisfies the other criteria for patentability. That excluded subject matter includes abstract ideas, laws of nature, and natural phenomena. Abstract ideas include mathematical concepts, certain methods of organizing human activity, and mental processes. Certain methods of organizing human activity include fundamental economic practices, commercial or legal interactions, and managing

personal behavior. The abstract idea exception is often applied to software inventions, so care must be exercised in drafting a patent application directed to a software invention to ensure that the application is not directed to a patent-ineligible abstract idea.

The second requirement is novelty (i.e., the invention must be new). In 2013, the United States revised its patent laws, in the "America Invents Act" (AIA), to become a "first-inventor-to-file" system; previously it was a "first to invent" system. Under the new laws, which are more harmonious with the laws of other countries in comparison to the prior "first to invent" system of the United States, novelty is judged as of the effective filing date of the application. As such, if the invention was patented, described in a printed publication, or in public use, on sale, or otherwise available to the public before the effective filing date, the invention is not novel. An invention is also not novel if it is described in a patent or published patent application that names another inventor and was filed before the effective filing date of the application.

There are exceptions. One exception is that a prior disclosure of the invention does not preclude novelty if the disclosure was made one year or less before the effective filing date of the application and the disclosure was made by the inventor or another person who obtained the subject matter from the inventor. Another exception is that a prior disclosure less than one year before the effective filing date by another party does not preclude novelty if the inventor publicly disclosed the invention prior to the other party's disclosure. The exceptions are why the U.S. system is referred to as the "first-***inventor***-to-file" system, whereas most other countries have simply "first-to-file" systems.

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

> A patent may not be obtained . . . if the differences between the claimed invention and the prior art are such that the claimed invention as a whole would have been obvious before the effective filing date of the claimed invention to a person having ordinary skill in the art to which the claimed invention pertains.

The factors considered in determining whether a claimed invention would have been obvious include the differences between the claimed invention and the prior art and the level of ordinary skill in the art. Secondary considerations may also be considered in determining whether a claimed invention would have been obvious. Secondary considerations include 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.

II. 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 non-U.S. company can take in establishing operations in the United States.

Under the AIA, a U.S. patent application can be filed in the name of a company to which the application is assigned or to which the inventor is obligated to assign the application. The company can also record the assignment at the USPTO to evidence its ownership. There is a continuing duty during the patent application review process to disclose to the USPTO relevant information bearing on the patentability of the application, including other patents, patent applications, references, and publications. This can be a significant obligation where there are corresponding non-U.S. applications for the invention. Every time that a non-U.S. patent office rejects a corresponding non-U.S. application over a prior art reference, that reference usually has to be disclosed to the USPTO (unless it was not previously disclosed).

When granted, a U.S. 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 USPTO in examining the application.

III. International Patent Protection

Patents are territorial. A U.S. patent can only be enforced against infringing activity in the United States. Separate patent applications need to be filed in other countries where patent protection is desired. 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 many other countries is that U.S. law provides the above-described "one-year grace period" to file a patent application in the United States. That is, an inventor (or the assignee) can file a patent application with the USPTO up to one year after a public disclosure of the invention (assuming that the inventor was the first to publicly disclose the invention or, if not, that the other discloser derived the invention from the inventor's work, as described above). Many other countries do not have such a "one-year grace period"; instead they have absolute novelty requirements.

Further, the patent laws of many other countries require that the invention be "worked" locally to keep the patent. Otherwise, the patent owner may be required to license the patent in the other country. U.S. 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.

IV. 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 150 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 (or assignee) to file a single PCT patent application with an appropriate "Receiving Office" (usually the patent office of the inventor's/assignee's home country) and then subsequently, within 30 to 42 months (depending on the country) from the effective filing date, nationalize that PCT application in its desired PCT signatory countries. The U.S. nationalization deadline is 30 months.

Many countries have national security laws that prohibit filing a patent application for an invention in other countries unless either (i) a patent application is first filed in the country where the invention was made or (ii) a waiver is obtained from the government of the country where the invention was made. Thus, a convenient, but not the only way, to file a U.S. patent application for an invention made outside the United States is a three-step process to: (a) file an initial patent application in the country where the invention is made; (b) file a PCT application within 12 months of the initial patent application in an appropriate Receiving Office for the inventor or assignee; and then (c) nationalize the PCT application within 30 months from the initial patent application.

In addition to the PCT, the United States and approximately 175 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 non-U.S. 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.

C. Trademarks and Service Marks

In the United States, a trademark can be any identifier that indicates the origin of goods and distinguishes them from the goods of others. Similarly, a service mark can be any identifier that 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 to the owner of the registered mark and provide notice of the existence of the trademark or service mark. Under U.S. 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 provides comparable trademark filing protocols. However, there is a critical distinction in the Paris Convention for trademarks relative to patents. 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 non-U.S. company may be foreclosed from offering its products under its non-U.S. trademarks in the United States if pre-existing trademark rights for the same or similar goods / services are present in the United States. Consequently, if a non-U.S. company contemplates selling a product (or offering a service) under a particular trademark (or service mark) in the United States, it is advisable to conduct a search in the United States for any conflicting trademarks (or service marks). This includes searching both registered and unregistered U.S. marks. It is also advisable to register a trademark (or service mark) in the United States early to prevent competitors from selling a competing product (or offering a competing service) under a confusingly similar trademark (or service mark).

Non-U.S. companies have an advantage over U.S. domestic companies in obtaining U.S. 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 non-U.S. company, under the Paris Convention or the General Inter-American Convention for Trademark and Commercial Protection (providing harmonized trademark

protection in many countries of the Americas), may be able to obtain a U.S. registration without actual use in the United States, provided that the non-U.S. company has filed an application or obtained a registration in a 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 the trademark rights in the United States, and the registration may be subject to cancellation on the grounds of abandonment.

D. 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) that are fixed in a tangible medium of expression (note that computer memory can qualify as a tangible medium for software works). A copyright exists as soon as the original work is fixed in the tangible medium, so registration with the U.S. Copyright Office is not required to obtain a copyright. However, before an action for copyright infringement can be brought against an infringer, the copyright must be registered with the U.S. Copyright Office. If copyright registration is obtained prior to the commencement of the infringement, the copyright owner may be entitled to damages for infringing conduct prior to the infringement suit.

The duration of a copyright varies. For works created by individual authors after 1 January 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 provide some coordination of copyright laws. The United States and approximately 175 other countries are parties to the Berne Convention for the Protection of Literary and Artistic Works (Berne Convention). The Berne Convention provides that a 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.

E. 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. To that end, a trade secret can pertain to information that is not otherwise patentable. 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 both state and federal law. Most (but not all) state trade secret laws are modeled after the Uniform Trade Secrets Act, and in 2016 the U.S. Congress passed the Defend Trade Secrets Act, which is also based on the Uniform Trade Secrets Act and which allows an owner of a trade secret to sue in U.S. federal court when its trade secret has been

misappropriated. The Economic Espionage Act of 1996 makes theft or misappropriation of certain trade secrets a federal crime.

F. 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 190 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 26 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**.

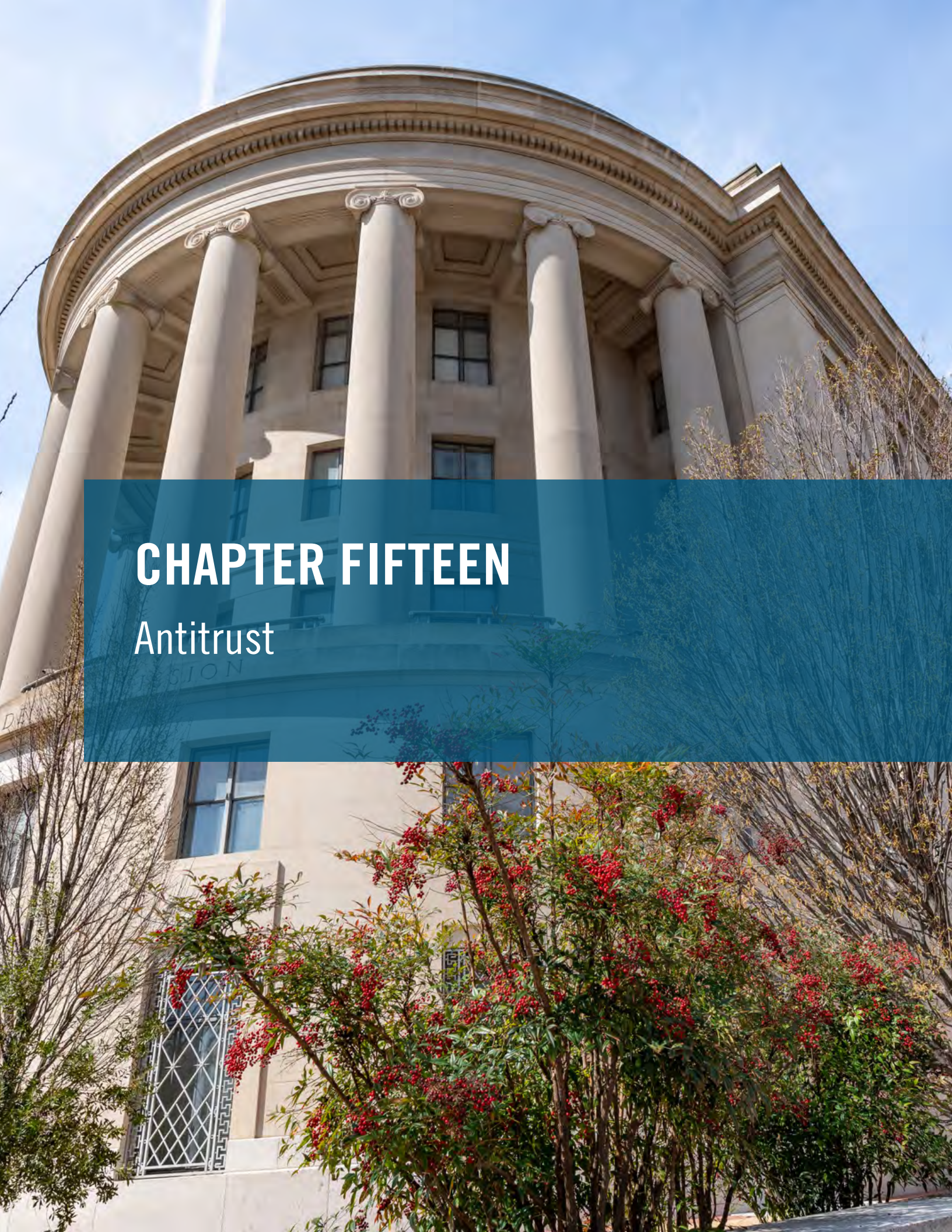
G. Licensing

The various costs of doing business directly in the United States may make it prohibitive for a non-U.S. 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 non-U.S. 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 non-U.S. 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 non-U.S. company and other licensees from also using the intellectual property in the specified territory, or (ii) non-exclusive, permitting the non-U.S. 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 enforcing (and willing to enforce) 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 enforce the intellectual property also assumes that the licensee can properly monitor whether the intellectual property is being infringed, stolen, or misused.
- What marking and quality control requirements are needed? Often, the licensee must comply with the marking requirements of U.S. law by including ® for registered trademarks, U.S. patent number, etc. In addition, appropriate quality control provisions must to be included in a trademark license agreement to ensure the quality of the goods/services offered under the trademark.
- What warranties and indemnification rights will be provided to the licensee? The licensee will expect, at a minimum, a warranty that the non-U.S. company has the authority to grant the license. Another, often negotiated issue is whether the non-U.S. company licensor will indemnify the licensee against claims of infringement.
- Will the non-U.S. company or licensee receive information that it must treat as confidential and, if so, what confidentiality and use restrictions are to be imposed?
- 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 11, *United States Business Acquisitions*).
- How can the non-U.S. company enforce its rights against the licensee? Is injunctive relief available under applicable laws? What dispute resolution alternatives are most appropriate?



CHAPTER FIFTEEN

Antitrust

Chapter Fifteen

ANTITRUST

A. Introduction

Free markets and private ownership are the hallmarks of the U.S. economic system. The purposes of antitrust laws are to preserve and protect the competition on which those concepts are based. In that regard, the U.S. 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 lawyers' fees. Violations can also result in costly private civil lawsuits by employees, competitors, or third parties alleged to have been injured by the violation.

It should be noted that U.S. 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 U.S. 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 non-U.S. companies to U.S. 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 South 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 11, *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 US$100 million are not unusual. Individuals, including corporate employees involved in the offending conduct, may not only be fined but imprisoned for up to 10 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 lawyer's fees (even though in the United States, generally, each party pays its own lawyer’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 U.S. 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 activities 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. An agreement need not be formal or in writing to violate the antitrust laws—any kind of informal or tacit agreement such as a "gentlemen's agreement" or some other implied understanding is similarly prohibited. 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. Unlawful arrangements may be inferred from circumstantial evidence. For example, exchanges among competitors of competitively sensitive information related to prices, customers, or output can be used to infer an agreement. 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; and
- 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 U.S. 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 U.S. 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

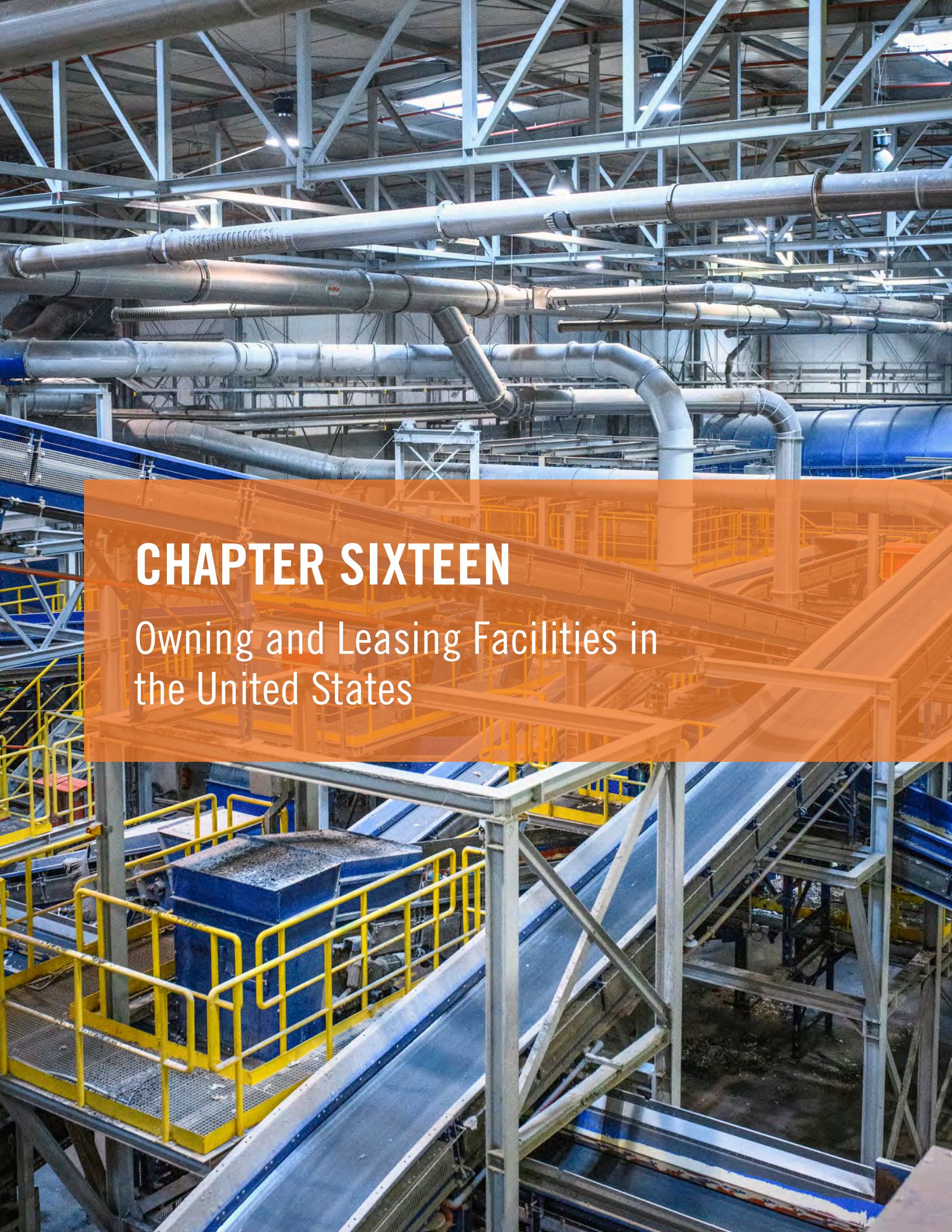
The Clayton Act prohibits stock or asset acquisitions that may substantially lessen competition in any relevant market. The Antitrust Division of the Department of Justice and the Federal Trade Commission have jointly issued "Merger Guidelines" that set forth the basis upon which governmental agencies 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 11, *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. The Robinson-Patman 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 SIXTEEN

Owning and Leasing Facilities in the United States

Chapter Sixteen

OWNING AND LEASING FACILITIES IN THE UNITED STATES

A. Introduction

There are many laws in the United States that deal with the ownership, leasing, and use of real property. Some of those laws have particular application to non-U.S. companies (such as the Foreign Investment in Real Property Tax Act, the Agricultural Foreign Investment Disclosure Act of 1978, and certain regulations promulgated by the Committee on Foreign Investment in the United States). Those laws and regulations, 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 non-U.S. 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 U.S. 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 U.S. real property interests that amount to more than half of the value of that corporation can qualify as a U.S. real property interest. Real property interests also include instruments such as (i) options to acquire interests in U.S. real property, and (ii) rights to share in the appreciation of U.S. real property ("equity kickers"). Interests in U.S. real property solely as a creditor, or pursuant to a security interest, typically are not considered U.S. real property interests.

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

CFIUS is a federal interagency committee that was formed to review transactions involving non-U.S. companies (or individuals) that might threaten the national security of the United States or that otherwise involve critical infrastructure of the United States and to advise the president of the United States regarding the same. The Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) granted CFIUS jurisdiction to review the lease or purchase of real property by non-U.S. companies (or individuals). In 2020, CFIUS created a "Geographic Reference Tool" (available online) to assist in determining whether a parcel of real property would be considered "covered real estate" subject to CFIUS review. In general, covered real estate is real property located in and/or around airports, maritime ports,

or military installations in the United States. Although CFIUS filings for covered real estate are voluntary, failing to make a CFIUS filing may result in an order requiring the non-U.S. person to divest the real estate. Counsel should be sought regarding the advisability of making these filings. For further detail concerning the applicability of CFIUS, *see* Chapter 6, *Regulation of Non-U.S. Companies*, and Chapter 11, *United States Business Acquisitions*.

D. Agricultural Foreign Investment Disclosure Act of 1978 (AFIDA)

AFIDA created a nationwide system for the collection of information about non-U.S. ownership of agricultural real property in the United States. Under AFIDA, non-U.S. individuals and entities are required to submit a report within 90 days following the acquisition or transfer of an interest in agricultural real property in the United States, including the acquisition or transfer of a 10 percent or greater ownership interest in a U.S. entity that owns agricultural real property (directly or indirectly) in the United States. AFIDA defines agricultural real property as real property that is currently used or *was* used within the past five years for farming, ranching, or timber production. Failure to submit the required report can result in penalties of up to 25 percent of the fair market value of the agricultural real property subject to such disclosure. In addition to the AFIDA requirements, certain states have passed legislation requiring disclosure or otherwise limiting the acquisition or transfer of agricultural real property by non-U.S. companies (and individuals). Counsel should be sought regarding the advisability and applicability of both AFIDA and state-level disclosures and limitations. For further detail concerning AFIDA, *see* Chapter 6, *Regulation of Non-U.S. Companies*.

E. 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 non-U.S. 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 non-U.S. 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.

Environmental Law	Description
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 includes the following:

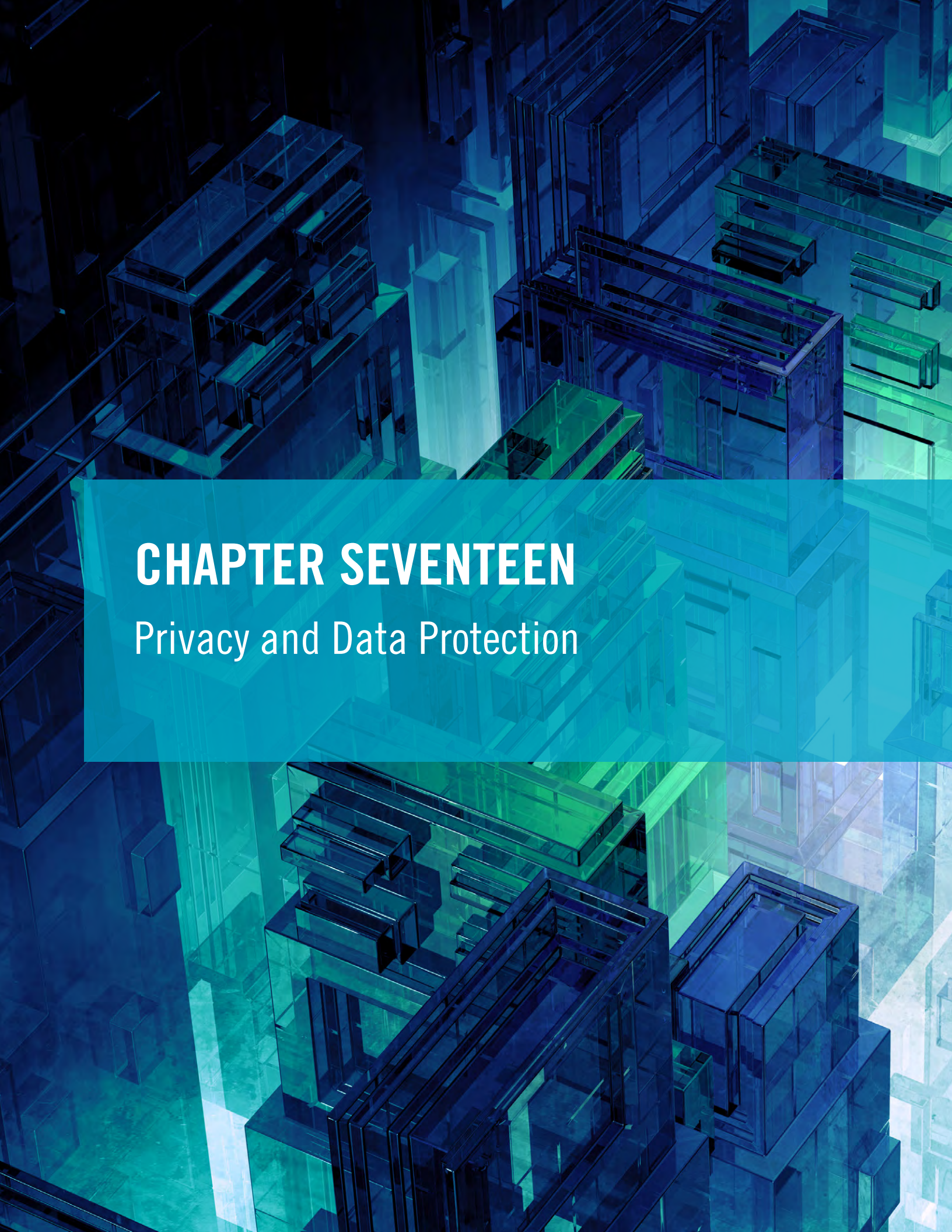
- Moving earth in wetlands areas or with resulting water sedimentation;
- Emitting, discharging, or releasing substances into the air or water;
- Generating hazardous waste;
- Treating, storing, or accepting hazardous waste for disposal;
- Transporting hazardous materials;
- Owning or operating underground storage tanks or pollution control devices;
- Spilling oil or hazardous substances; or
- 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 company, their application to a particular company should be thoroughly evaluated. Non-U.S. companies 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 company (or its 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 effects 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.

F. Local Zoning and Land Use Regulation

Non-U.S. 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 that jurisdiction. Whenever evaluating a potential site for a facility, a non-U.S. 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 lawyers can be of significant assistance in avoiding false starts in facility procurement.



CHAPTER SEVENTEEN

Privacy and Data Protection

Chapter Seventeen

PRIVACY AND DATA PROTECTION

The United States does not have a national privacy law or data protection authority. Rather, a variety of federal, state, and local laws and agencies regulate privacy and data protection. These laws and regulations are generally sector- and industry-specific. Companies doing business in the United States should take great care to determine which laws apply, based upon the company's industry, the type of information involved, and geographic location of the activity. This Chapter provides an overview of major areas of federal laws and regulations that address privacy and data protection, as well as key themes of applicable state laws. Each of the 50 states, as well as additional territories and local jurisdictions, have laws applying to data collection, data protection, and privacy. Because the language and interpretation of these laws vary considerably by jurisdiction, companies should seek counsel from a knowledgeable lawyer for creating and implementing privacy and data protection policies and procedures.

A. Federal Laws and Regulations

The federal laws and regulations applicable to the collection, use, and sharing of personal information depend upon the industry sector, the type of information collected, and the circumstances under which it is collected. Some of the key federal laws and regulations are described below. Also described below are laws and regulations governing electronic marketing and the use of personal information in connection with electronic marketing.

I. Consumer Protection

The Federal Trade Commission (FTC) regulates data protection and privacy under Section 5 of the Federal Trade Commission Act of 1914, which prohibits unfair or deceptive acts or practices in or affecting commerce. Under this authority, the FTC has articulated "fair information practice principles" (FIPPs) intended to serve as minimum standards of privacy protection:

- **Notice**. Data collectors must disclose their information practices before collecting personal information from consumers.
- **Choice**. Consumers must be given options with respect to the type of personal information collected, the purposes for processing that personal information, and whether the collected personal information may be used for purposes beyond those for which the personal information was provided.
- **Access**. Consumers should be able to view and contest the accuracy and completeness of data collected about them.
- **Security**. Data collectors must take reasonable steps to ensure that information collected from consumers is accurate and secure from unauthorized use.

Based upon these FIPPs, the FTC requires all businesses to clearly and accurately disclose their material information collection, use, and sharing practices in a written privacy policy. Further, a business must comply with the policies that it presents to the public. The FTC routinely prosecutes companies that do not post accurate privacy policies or do not comply with the policies that they post.

The FTC has also held that it is an unfair business practice for a company, regardless of its size and revenue, to collect personal or sensitive customer data and not employ adequate security measures to protect that data. The FTC routinely investigates data breaches and brings enforcement actions against companies where they find the breach was caused by inadequate data security practices or the failure of that company to abide by its own security policies. When creating and implementing data security policies and procedures, companies doing business in the United States should refer to these enforcement actions, as well as guidance issued by the FTC. The FTC publishes such guidance on relevant topics and includes issues such as building security safeguards into products connected to the "Internet of things," avoiding unauthorized disclosures for businesses buying and selling debt, and protecting against cybersecurity attacks.

II. Financial Personal Information

Personally identifiable nonpublic financial information (NPI) held by banks, securities firms, real estate appraisers, check cashers, tax preparers, insurers, mortgage brokers, and other financial institutions must comply with regulations and privacy notice requirements promulgated pursuant to the Graham-Leach-Bliley Act and its regulations. These financial institutions are required to protect the privacy of NPI. Among other requirements, the financial institutions must provide privacy notices to customers that describe the NPI collected, as well as the policies and procedures designed to protect the privacy and security of the NPI. Prior to disclosure of NPI to a third party, the customers must be given an opt-out notice explaining the customer's right to direct the institution not to share his or her NPI, as well as a reasonable method to opt out before the NPI is shared.

III. Consumer Credit Reporting Agencies

The Fair Credit Reporting Act (FCRA) regulates the collection, use, and sharing of consumer credit information. Along with other requirements, FCRA requires that credit-reporting agencies limit access to credit reports to those seeking access for permissible purposes. The FCRA also requires credit-reporting agencies to investigate correct and delete inaccurate information from credit reports.

IV. Credit Card Information

In general, the use and storage of credit card information, including digital information, are regulated by the Payment Card Industry Security Standards Council. This is a private trade association that issues detailed data security standards for credit card information called the Payment Card Industry Data Security Standards (PCI DSS). The FTC has brought enforcement actions against businesses that collect payment card information and have failed to comply with PCI DSS. Businesses that are collecting or processing credit card information are required to use and protect such information in accordance with PCI DSS standards. Further, as discussed above, failure to adhere to those standards constitutes a deceptive trade practice, which can result in enforcement actions and fines by the FTC and state governments.

V. Health and Medical Personal Information

Individually identifiable health information collected, transmitted, or maintained by healthcare providers, health insurance companies, and other similar entities (Covered Entities) are regulated by the Health Insurance Portability and Accountability Act of 1996 (HIPAA) and the Health Information Technology for Economic and Clinical Health Act, (HITECH Act). Individually identifiable health information (referred to as Protected Health Information (PHI)) is information that relates to past, present, or future physical or mental health condition of an individual or the provision of healthcare to an individual. HIPAA requires

Covered Entities to provide individuals with proper notice and consent prior to collecting, processing, and transferring PHI. HIPAA and the HITECH Act also require Covered Entities to take substantive steps to protect PHI in their possession. To ensure security with respect to sharing PHI with other companies, Covered Entities are required to enter into signed agreements with service providers (Business Associates) prior to providing such Business Associates with access to PHI. These agreements, called Business Associate Agreements or BAAs, require Business Associates to protect PHI by implementing various data security measures, as required by HIPAA and the HITECH Act.

HIPAA is enforced by the United States Department of Health & Human Services and includes penalties based on levels of non-compliance. These penalties are adjusted for inflation every year and vary based upon the degree of culpability. In 2020 the penalties ranged from US$119 to US$59,522 per violation, with a maximum penalty of US$1.7 million per year. Violations can also result in criminal charges and jail time. The most common, and most publicized, violations stem from data breaches. A data breach is essentially an impermissible use or disclosure under HIPAA and the HITECH ACT that compromises the security or privacy of PHI. The HIPAA Breach Notification Rule requires Covered Entities and their Business Associates to provide notification following a breach of unsecured PHI. One of the largest HIPAA settlements in history was due to a Covered Entity's failure to protect its PHI, which led to the loss of four million PHI records and resulted in a US$5.5 million fine. Needless to say, companies that are within the scope of HIPAA should regularly update their HIPAA compliance protocols to ensure the proper protection of PHI.

VI. Employment-Related Personal Information

In the United States, there is no uniform employee-related personal information law or regulation. However, there are applicable provisions within different industry-specific laws and regulations that address personal information collected by employers. In general, employers can only request medical information when it is relevant to the job in question. The Americans with Disabilities Act requires medical information that is obtained from applicants or employees to be maintained separately and kept confidential. In general, an employer cannot use an employee's medical information to prevent employees from coming to work, although amendments to this legal requirement were passed that permit certain limited exceptions, primarily due to the COVID-19 pandemic and the resulting recession.

Additionally, FCRA requires employers to obtain written authorization from an applicant before conducting a background check. The information that can be obtained in a background check is limited and can be used by the employer only within the scope of the authorization.

Under the Electronic Communications Privacy Act of 1986, an employer may not monitor employee communications, which includes phone, e-mail, and other company-based communication software, without employee consent unless the employer can demonstrate that the monitoring is for legitimate business reasons.

VII. Personal Information of Children

Digital services that are directed to children under the age of 13 (Child or Children) and collect personal information about Children are regulated by the Children's Online Privacy Protection Act (COPPA). COPPA was enacted in 1998 and is regulated by the FTC. State Attorneys General may also enforce COPPA on behalf of residents in their state. Under COPPA, personal information of a Child may not be collected unless the digital service:

- Provides direct notice to the parent of the Child of its practices regarding collection, use, and disclosure of personal information from Children;
- Provides direct notice to the parent of the Child of its data management practices before collecting personal information from Children;
- Obtains verifiable parental consent from the parent of the Child before any collection, use, or disclosure of personal information;
- Provides a means for the parent to review the personal information collected from a Child and to refuse to permit its further use or maintenance of that information; and
- Establishes and maintains reasonable procedures to protect the confidentiality, security, and integrity of personal information collected from the Child.

State laws may have more restrictive requirements applicable to Children. For instance, California state law requires businesses to obtain express consent prior to the sale of any personal information about a California consumer when the business has actual knowledge that such consumer is less than 16 years old. This consent must come from the parent or guardian if the consumer is under the age of 13.

VIII. Student Records

Student educational records are regulated by the Family Educational Rights and Privacy Act (FERPA). FERPA applies to schools that receive funds under certain programs administered by the United States Department of Education. Educational records are records that contain information directly related to a student; and are maintained by a school or by an organization acting on behalf of a school.

Under FERPA, parents of students under the age of 18, students age 18 or older, and students attending college or other post-high school educational programs ("eligible students") have certain rights regarding their educational records. These rights include the parent or eligible student's right to inspect and review the student's education records and to request that a school correct records which they believe to be inaccurate or misleading. Schools must notify parents and eligible students of their rights under FERPA on an annual basis.

FERPA also requires schools to receive a parent or student's written permission to release student educational records to third-parties. However, schools may release educational records without permission to: school officials, schools to which the student is transferring, officials for audits or evaluations, financial aid institutions, organizations conducting research on behalf of the school, accrediting organizations, and to a limited number of other circumstances.

Schools may also release certain information such as a student's name, address, telephone number, date of birth, and dates of attendance ("directory information") without consent. However, a school must provide a parent or eligible student with the opt-out of the release of the student's directory information.

B. State Laws and Regulations

Every state has laws concerning the collection, use and disclosure of personal information, and each state law varies in scope, application, requirements, and enforcement. Even the definition and scope of "personal information" varies among the states' laws. This section provides an overview of the laws generally adopted by the states and highlights specific state laws that regulate the privacy and security of personal information. Given that this area of law is constantly changing and can result in serious penalties

for non-compliance, it is important to consult a knowledgeable lawyer for an accurate interpretation of the law currently applicable in any state.

I. Privacy Policies

Most states have laws that require that, prior to collection of personal information, notice be provided or made available disclosing a business' collection, use, and disclosure practices as well as the choices that consumers have regarding their personal information. This requirement is usually satisfied by use of an appropriate privacy policy publicly posted on the business' website and hyperlinked when data collection occurs.

II. State Deceptive Trade Practice Laws

In addition to federal laws enforced by the FTC, every state has laws prohibiting unfair and deceptive trade practices. These laws permit state Attorneys General to bring an enforcement action when consumer information is collected in violation of a company's privacy policy or where such information is not appropriately secure.

Some states have additional laws regarding the duty specifically to protect data collected from consumers or personal information. These laws also require standards for the handling of confidential personal information, including social security numbers, credit card information, and other information, which can result in identity theft. Violation of these state laws can typically involve criminal liability, as well as civil fines and other remedies.

III. The California Consumer Privacy Act of 2018

California has enacted the broadest consumer privacy act in the United States, called the California Consumer Privacy Act of 2018 (CCPA). The CCPA became effective 1 January 2020, and imposes substantial requirements and restrictions on the collection, use, and disclosure of personal information of California residents by for-profit businesses. The CCPA defines "personal information" extremely broadly as "information that identifies, relates to, describes, is capable of being associated with, or could reasonably be linked, directly or indirectly, with a particular consumer or household." Essentially, any information regarding a California resident's characteristics and behaviors, personal and commercial, as well as inferences drawn from this information that can be used to identify an individual, is included within the definition of "personal information." The CCPA has broad requirements, including but not limited to the following:

- At or before collection of personal information, consumers must be notified of the categories of personal information being collected and the use of such personal information by the business.
- The business is required to have a privacy policy that discloses the categories of personal information sold by the business in the prior 12 months; the purposes for which the business collects, uses, and sells personal information; the categories and sources from which the business collects personal information; the categories of third parties to whom the business discloses personal information; and the rights afforded to consumers, including the right to access, delete, and opt out, as well as how to exercise such rights.
- A "Do Not Sell My Personal Information" link on the business' website and a page where consumers can opt out of the sale of their personal information.
- Most businesses are required to provide at least two methods for consumers to submit CCPA requests to the business, including an online method and toll-free number.

- Consumers have a right to not be discriminated against for exercising their rights under the CCPA.
- Consumers have a private right of action for certain data breaches that result from violations of a business' duty to implement and maintain reasonable security practices and procedures appropriate to the risk to personal information.

The CCPA applies to for-profit businesses that collect and control California residents' personal information, do business in California, and meet one of these three requirements:

- Have annual gross revenues in excess of US$25 million;
- Receive or disclose the personal information of 50,000 or more California residents, households, or devices on an annual basis; or
- Derive 50 percent or more of their annual revenues from selling California residents' personal information.

The CCPA only applies to the personal information of California residents and places additional restrictions on personal information about children. The CCPA prohibits the selling of personal information of a consumer under the age of 17 without parental or legal guardian consent. Children between the ages of 13 and 16 can directly provide their consent, but the selling of personal information about a child under the age of 13 requires parental or legal guardian consent. Most importantly, the protections provided by COPPA still apply on top of the CCPA's requirements with respect to children's personal information.

IV. State Breach Notification Laws

All 50 United States states, the District of Columbia, Guam, Puerto Rico, and the Virgin Islands have enacted legislation requiring private companies or governmental entities to notify individuals and/or state authorities of security breaches of information involving personally identifiable information.

State security breach laws generally include the following provisions:

- Who is required to comply (e.g., businesses, government entities, data or information brokers);
- The definition of "personal information" (e.g., driver's license, state ID, name combined with social security number, account numbers);
- What constitutes a breach (e.g., unauthorized access of personal information, unauthorized acquisition of personal information);
- The requirements for notice (e.g., individuals that are required to be notified, timing or method of notice); and
- Exemptions (e.g., good-faith acquisition, public information, encrypted information, redacted information).

V. Biometric Information

In recent years, states have increased protections for biometric information either through stand-alone legislation or by expanding the scope of the definition of personal information under existing privacy laws. The biometric information covered by these laws varies. Under the California CCPA, "Biometric information" is broadly defined to mean an individual's physiological, biological, or behavioral characteristics that can be used, singly or in combination with each other or with other identifying data, to establish individual identity. Biometric information, which includes imagery of the iris, retina, fingerprint, face, hand, palm, vein patterns, and voice recordings, from which an identifier template, such as a

faceprint, a minutiae template, or a voiceprint, can be extracted, and keystroke patterns or rhythms, gait patterns or rhythms, and sleep, health, or exercise data that contain identifying information.

The Illinois Biometric Information Privacy Act (BIPA), which was enacted in 2008, is the first and oldest biometric information privacy law in the United States. Importantly, unlike other state laws, BIPA provides consumers with a private right of action against a business that violates the act. Illinois' BIPA requires businesses to first provide proper notice and obtain consent prior to collecting biometric information. Specifically, under BIPA, a business may not collect, capture, purchase, receive through trade, or otherwise obtain biometric information of an individual unless it first: (i) provides written notice to the individual that a biometric identifier or biometric information is being collected or stored; (ii) provides written notice to the individual about the specific purpose and duration for which a biometric identifier or biometric information is being collected, stored, and used; and (iii) obtains a signed written release from the individual.

BIPA also prohibits a business from selling, leasing, trading, or otherwise profiting from an individual's biometric information. Under BIPA, a business may not disclose biometric information unless authorized by the individual except as required by law or pursuant to a subpoena. Further, BIPA requires businesses to secure and protect biometric information from improper disclosure during storage and transmission.

In addition to California and Illinois, as of this writing, six other states have passed their own biometric information privacy laws or expanded their existing privacy laws to include biometric information: Arkansas, Louisiana, New York, Oregon, Texas, and Washington. The application and scope of these laws vary.

VI. Location Information

Where applicable, location information has traditionally been included within the definition of "personal information" in federal and state regulations. However, in the near future, it is likely that more state laws will require specific notice and consent in order to collect location information from consumers.

C. Electronic Marketing Practices

Privacy and data protection became a heightened concern due to the ability of companies to advertise directly to consumers using the personal information collected from them. Both federal and state laws regulate certain unsolicited marketing and communication, as outlined below:

- **Email**. The Controlling the Assault of Non-Solicited Pornography And Marketing Act of 2003 (CAN-SPAM Act) requires companies sending commercial email marketing messages to include a method for the individual to opt out of receiving such messages. If the consumer opts out and such opt out is not honored by the company, the CAN-SPAM Act provides enforcement power to the FTC and state Attorneys General to penalize violating companies.
- **Text messaging**. Businesses are required to obtain express consent to send text messages to individuals. Failure to obtain appropriate consent can lead to fines and class-action lawsuits.
- **Fax**. Federal law and regulations generally prohibit the sending of unsolicited advertising by fax without prior express written consent.
- **Unsolicited calls to wireless phone numbers.** Prior express consent is required to place phone calls to wireless numbers using any autodialing equipment and for any commercial marketing.

- **Telemarketing**. There are federal and state telemarketing laws, and these laws vary in scope and application from state to state. Generally, these laws forbid the use of auto dialers, restrict the times during which such telemarketing calls can be made, and require the business using telemarketing to maintain records and allow consumers to opt out.

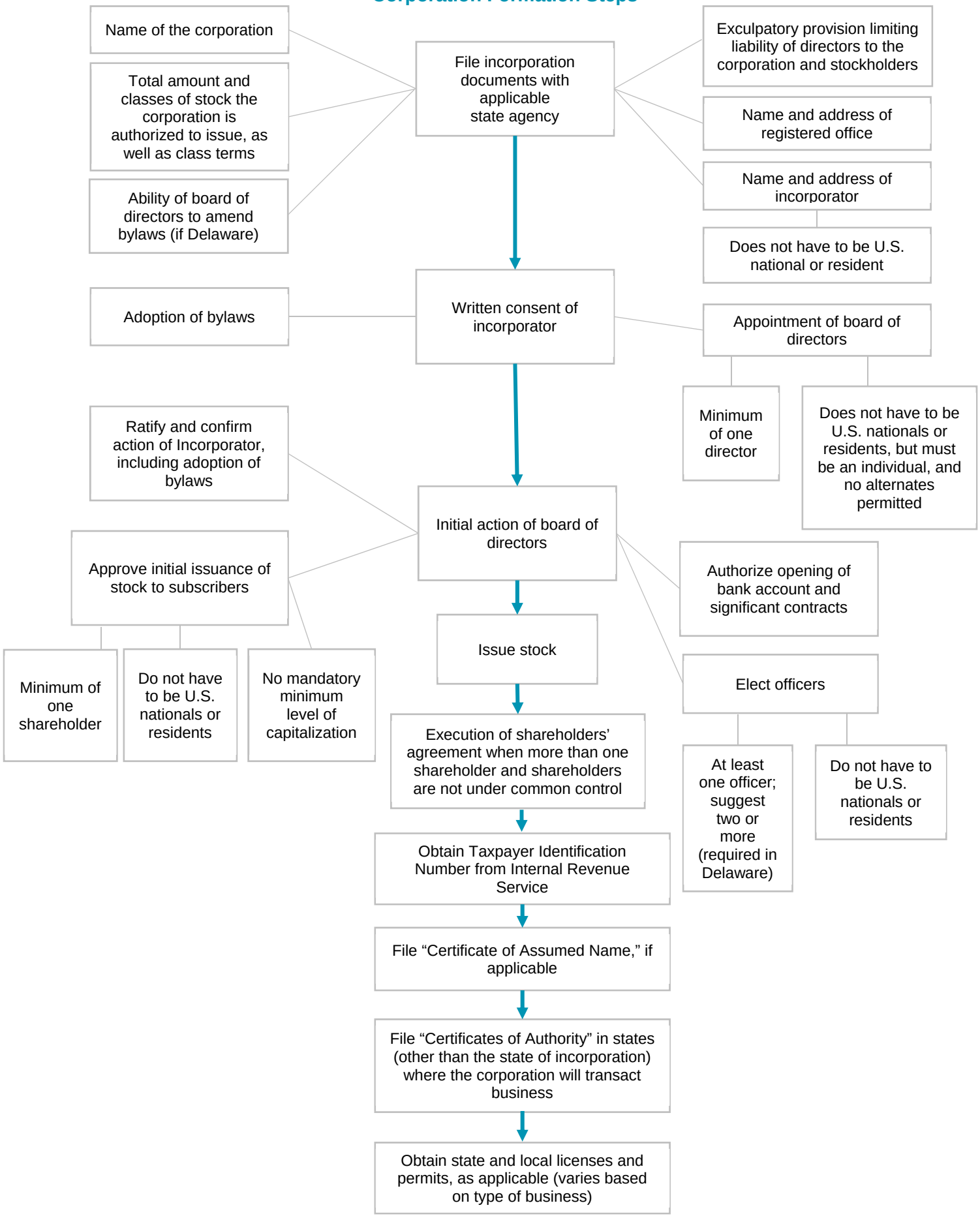
D. Future of Privacy and Data Protection in the United States

Following the enactment of the CCPA in California, many states are considering similar state-specific privacy laws. As a result, it is predicted that other states will enact comprehensive and more restrictive privacy laws like the CCPA in the near future. At the federal level, a number of new privacy bills have been introduced in Congress, which may then preempt the myriad state laws on the subject. These bills vary in the levels of protections provided to consumers and the restrictions placed on companies. As of this writing, none of these bills have been enacted into law, but it is clear that many members of Congress are pushing to pass a comprehensive federal privacy and data protection law to address growing national and international concerns for consumer data protection and to provide a single, comprehensive framework for the United States.

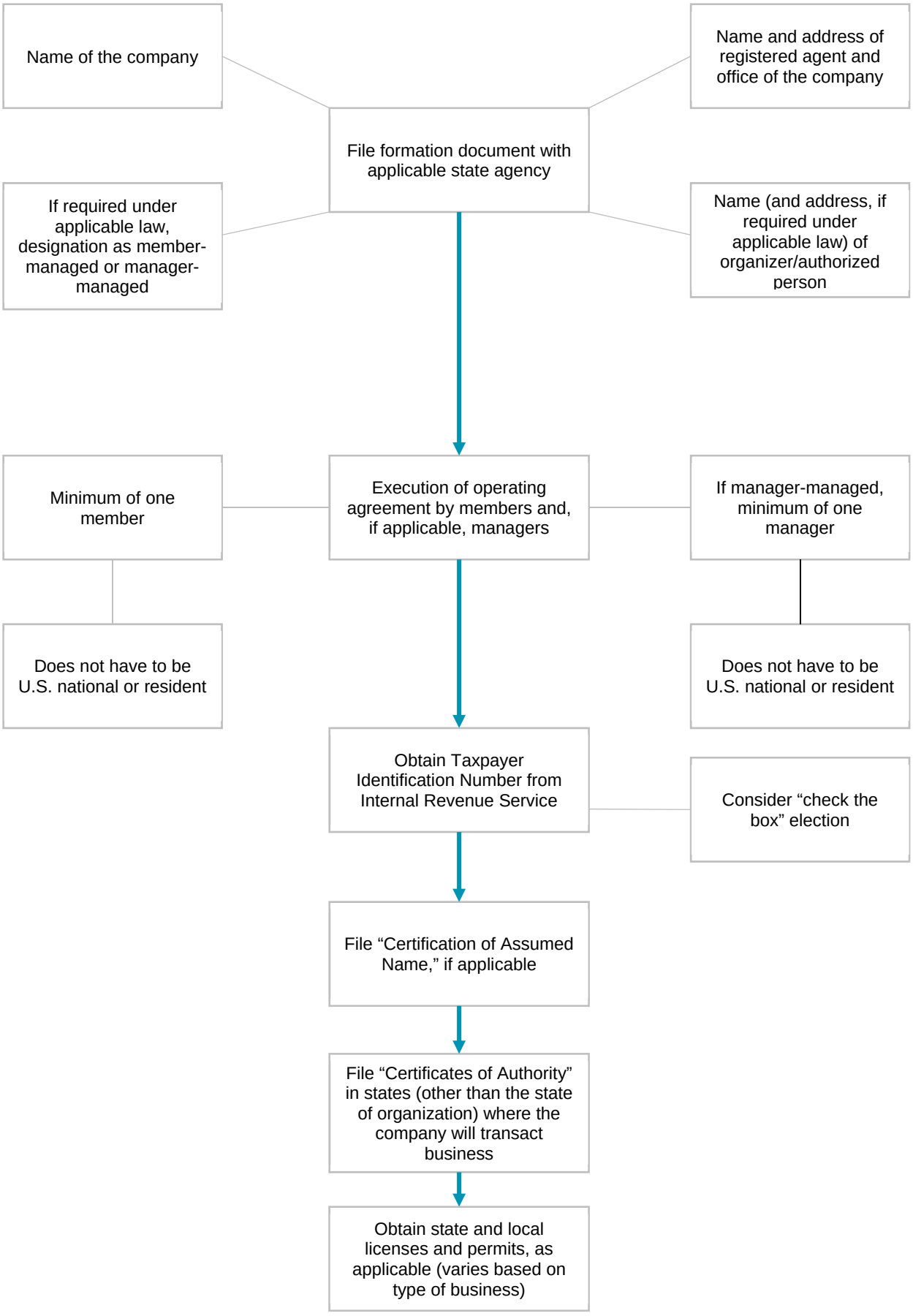
ATTACHMENTS

ATTACHMENT 1
Corporation and Limited Liability Company Formation Steps

Corporation Formation Steps



ATTACHMENT 1
Corporation and Limited Liability Company Formation Steps
Limited Liability Company Formation Steps



ATTACHMENT 2

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

Albania	Fiji	Mongolia
Argentina	Finland	Montenegro
Armenia	France	Netherlands
Australia	Gabon	New Zealand
Austria	Georgia	Norway
Azerbaijan	Germany	Palestine
Bahrain	Greece	Paraguay
Belarus	Guatemala	Peru
Belgium	Guinea	Poland
Benin	Guyana	Portugal
Bosnia & Herzegovina	Honduras	Romania
Brazil	Hungary	Russian Federation
Bulgaria	Iceland	St. Vincent & the Grenadines
Burundi	Iraq	San Marino
Cameroon	Israel	Serbia
Canada	Italy	Singapore
Chile	Japan	Slovak Republic
China (PRC)	Korea (South Korea)	Slovenia
Columbia	Kyrgyzstan	Spain
Congo	Laos	Sweden
Costa Rica	Latvia	Switzerland
Croatia	Lebanon	Syrian Arab Republic
Cuba	Lesotho	Turkey
Cyprus	Liberia	Uganda
Czech Republic	Liechtenstein	Ukraine
Democratic People's Republic of Korea	Lithuania	United States of America
Denmark	Luxembourg	Uruguay
Dominican Republic	Macedonia	Uzbekistan
Ecuador	Madagascar	Vietnam
Egypt	Mauritania	Zambia
El Salvador	Mexico	
Estonia	Republic of Moldova	

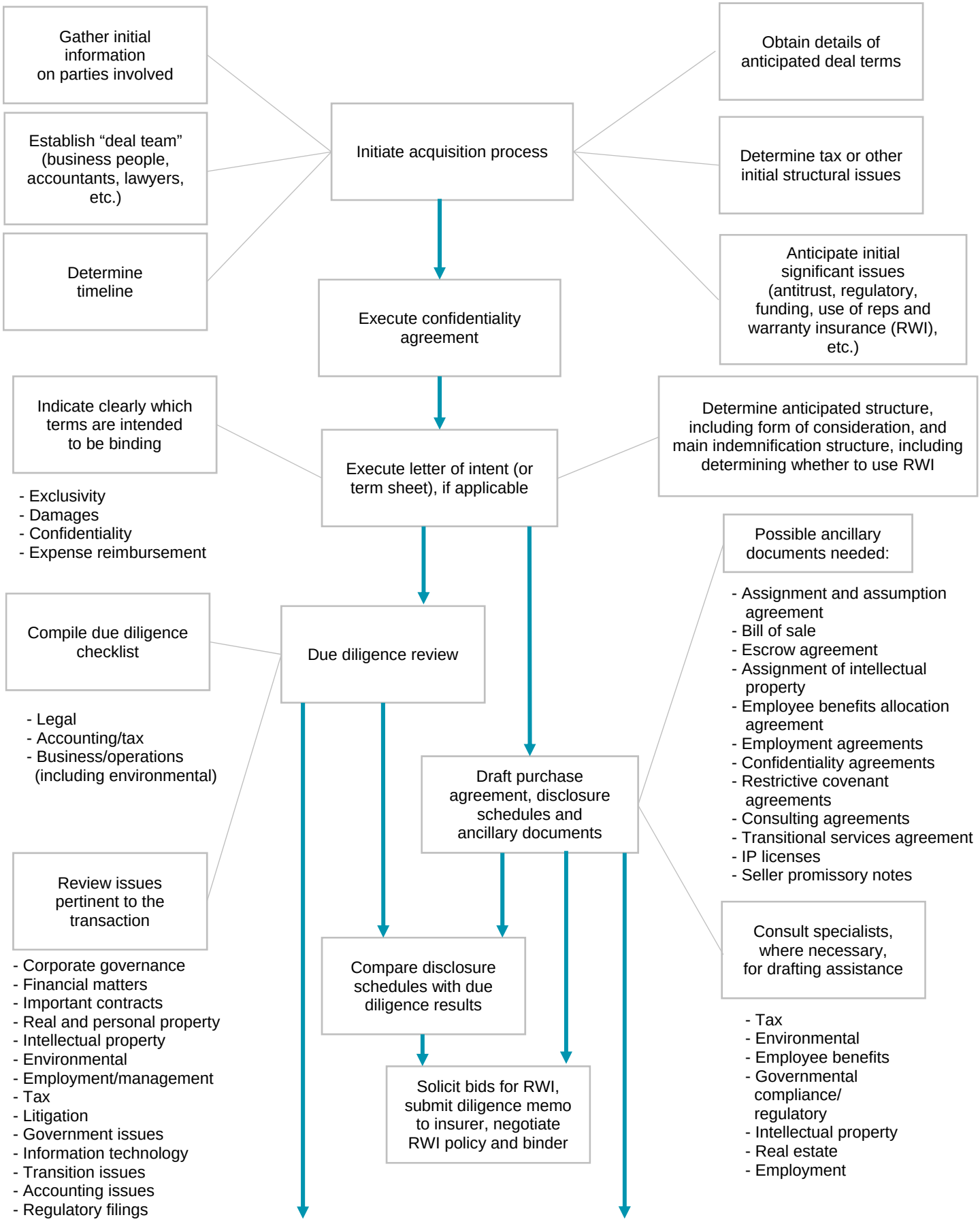
ATTACHMENT 3

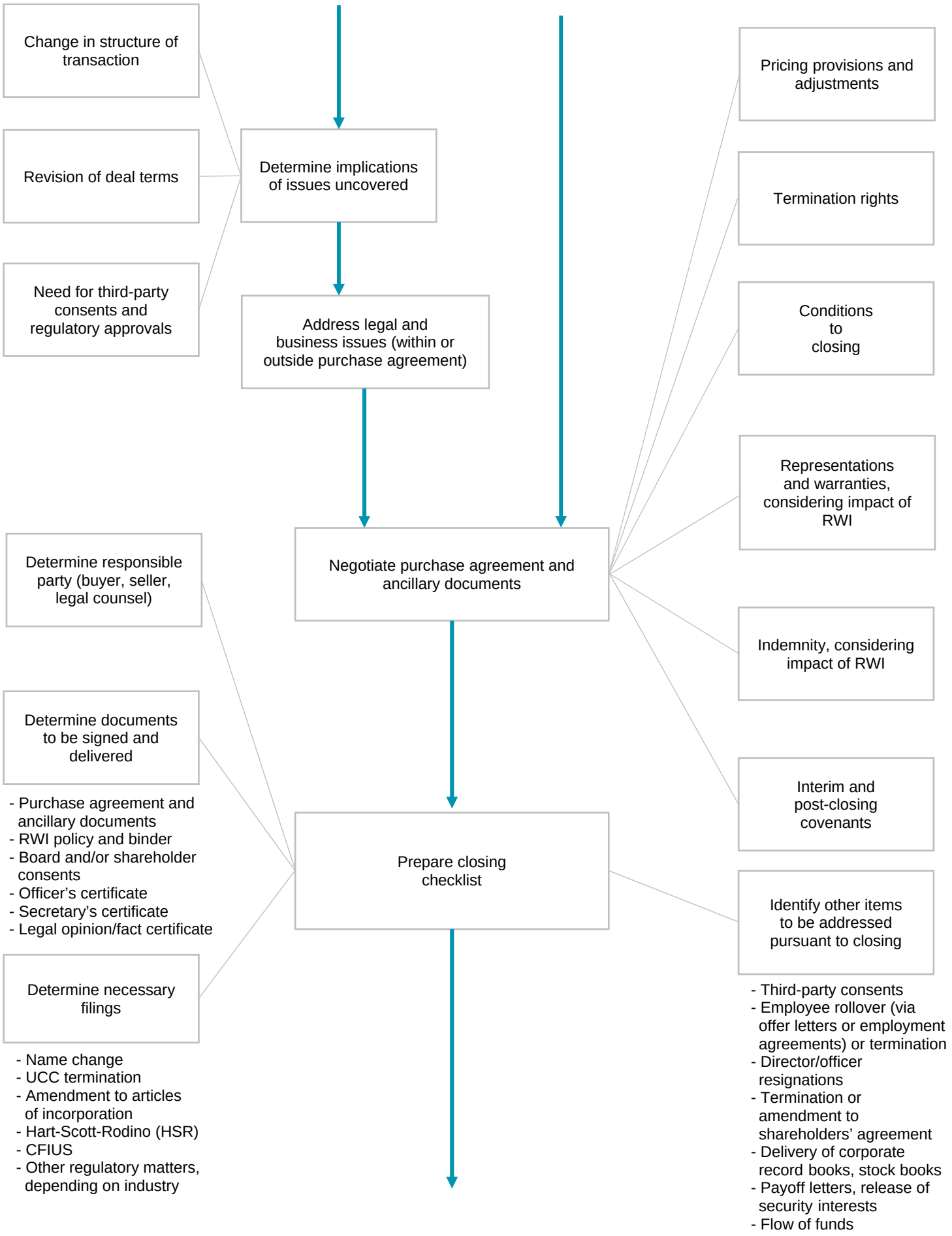
Parties to the New York Convention

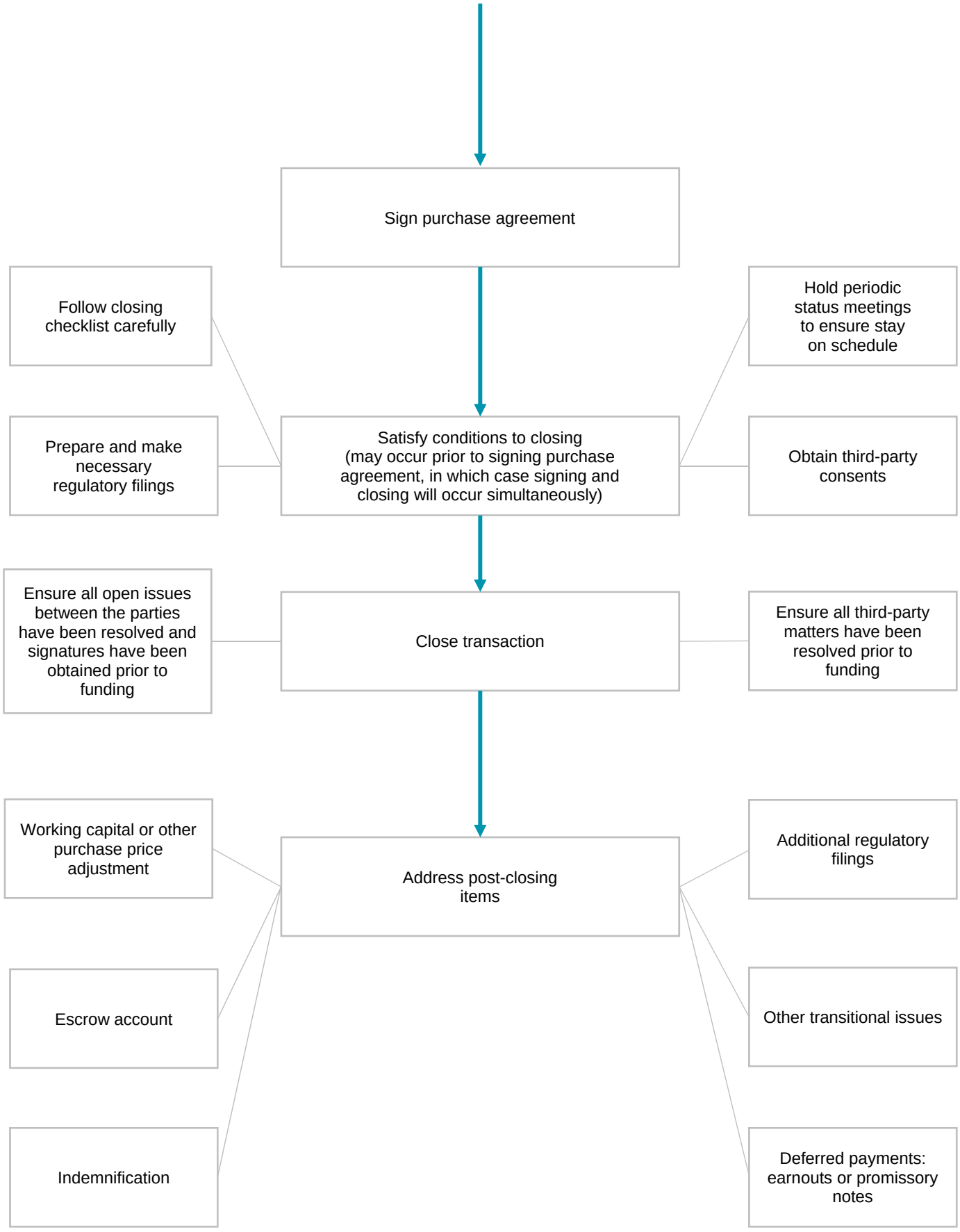
Afghanistan	Ghana	Nigeria
Albania	Greece	Palau
Algeria	Guatemala	Panama
Antigua and Barbuda	Guinea	Papua New Guinea
Andorra	Guyana	Paraguay
Argentina	Haiti	Peru
Angola	Holy See	Philippines
Armenia	Honduras	Poland
Australia	Hungary	Portugal
Austria	Iceland	Qatar
Azerbaijan	India	Republic of Korea
Bahamas	Indonesia	Romania
Bahrain	Iran	Russian Federation
Bangladesh	Ireland	Rwanda
Barbados	Israel	St. Vincent and the Grenadines
Belarus	Italy	San Marino
Belgium	Ireland	Sao Tome and Principe
Benin	Jamaica	Saudi Arabia
Bolivia	Japan	Senegal
Bhutan	Jordan	Serbia
Bosnia and Herzegovina	Kenya	Seychelles
Botswana	Kuwait	Singapore
Brazil	Kyrgyzstan	Slovakia
Brunei Darussalam	Lao People's Democratic Republic	Slovenia
Bulgaria	Latvia	South Africa
Burkina Faso	Lebanon	Spain
Burundi	Lesotho	Sri Lanka
Cabo Verde	Liberia	State of Palestine
Cambodia	Lichtenstein	Sudan
Cameroon	Lithuania	Sweden
Canada	Luxembourg	Switzerland
Central African Republic	Madagascar	Syrian Arab Republic
Chile	Malaysia	Tajikistan
China	Maldives	Thailand
Columbia	Mali	Tonga
Comoros	Malta	Trinidad and Tobago
Democratic Republic of Congo	Marshall Islands	Tunisia
Cook Islands	Mauritania	Turkey
Dominica	Monaco	Uganda
Dominican Republic	Mongolia	Ukraine
Ecuador	Montenegro	Britain and Northern
Egypt	Morocco	Ireland
El Salvador	Mozambique	United Republic of Tanzania
Estonia	Myanmar	United States of America
Fiji	Nepal	Uruguay
Finland	Netherlands	Uzbekistan
France	New Zealand	Venezuela
Gabon	Nicaragua	Vietnam
Georgia	North Macedonia	Zambia
Germany	Niger	Zimbabwe

ATTACHMENT 4

U.S. Business Acquisition Steps Flow Chart




Change in structure of transaction
Revision of deal terms
Need for third-party consents and regulatory approvals
Determine implications of issues uncovered
Address legal and business issues (within or outside purchase agreement)
Pricing provisions and adjustments
Termination rights
Conditions to closing
Representations and warranties, considering impact of RWI
Indemnity, considering impact of RWI
Interim and post-closing covenants
Negotiate purchase agreement and ancillary documents
Determine responsible party (buyer, seller, legal counsel)
Determine documents to be signed and delivered
- Purchase agreement and ancillary documents
- RWI policy and binder
- Board and/or shareholder consents
- Officer's certificate
- Secretary's certificate
- Legal opinion/fact certificate
Determine necessary filings
- Name change
- UCC termination
- Amendment to articles of incorporation
- Hart-Scott-Rodino (HSR)
- CFIUS
- Other regulatory matters, depending on industry
Prepare closing checklist
Identify other items to be addressed pursuant to closing
- Third-party consents
- Employee rollover (via offer letters or employment agreements) or termination
- Director/officer resignations
- Termination or amendment to shareholders' agreement
- Delivery of corporate record books, stock books
- Payoff letters, release of security interests
- Flow of funds


Sign purchase agreement
Follow closing checklist carefully
Hold periodic status meetings to ensure stay on schedule
Prepare and make necessary regulatory filings
Satisfy conditions to closing (may occur prior to signing purchase agreement, in which case signing and closing will occur simultaneously)
Obtain third-party consents
Ensure all open issues between the parties have been resolved and signatures have been obtained prior to funding
Close transaction
Ensure all third-party matters have been resolved prior to funding
Working capital or other purchase price adjustment
Address post-closing items
Additional regulatory filings
Escrow account
Other transitional issues
Indemnification
Deferred payments: earnouts or promissory notes

CONTRIBUTORS

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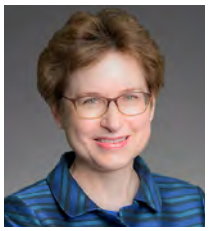
Editors



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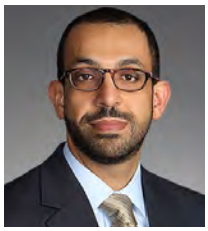

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