DOING BUSINESS IN THE USA:

A “BULLET POINT” GUIDE FOR INDIAN FIRMS

By

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Gallet Dreyer & Berkey, LLP (“GDB”) is a long established law firm located in the heart of New York City, offering a full array of legal and tax services. GDB is capable of handling client matters throughout the USA, as well as clients’ international legal and tax matters. Examples of GDB's fields of expertise include

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- contracts of all kinds,
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- law and contracts regarding construction and engineering projects;
- real estate;
- technology transfer and licensing; Internet and information technology law;
- industrial and intellectual property;
- computer law and contracts;
- customs law;
- insurance and insurance litigation;
- visas and immigration;
- tax law and tax planning;
- litigation, mediation and arbitration;
- trust and estate matters, including those involving international issues;
- sports and entertainment law.
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- Advising on Foreign Direct investments into India of all kinds, including acquisitions and mergers, joint ventures, setting up of companies and manufacturing facilities;
- Commercial Agreements of all kinds;
- Competition and trade practices;
- Corporate crime;
- Company, commercial law;
- Infrastructure and project finance;
- Shipping and Transport;
- Real Estate;
• Technology transfer and licensing;
• Internet and information technology law;
• Intellectual Property Laws;
• Biotechnology law
• Computer law and contracts;
• Insurance and Insurance litigation;
• Litigation, Mediation and Arbitration;
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PART I

THE PURPOSE OF THIS “BULLET POINT” BOOKLET

The main purpose of this booklet is to make you, the Indian business person, aware of some key issues that come up when doing business in the USA. This booklet simply gives an overview; it does not provide in-depth information. Nevertheless, armed with the information highlighted in this booklet, business people can be aware of pitfalls and areas that require further attention and care when considering business deals or when they have some other problem or matter involving the USA.

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Other cost-free of the writers are listed in the Appendix, and are available from them upon request.

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Caveat: The present Guide is not intended as a substitute for the advice of competent legal or other advisors in connection with any particular matter or issue, and should not be used as such. While the writers have made efforts to be accurate in his factual statements contained in this Guide, he does not make any representation or warranty in this regard. Opinions expressed herein are those of the particular writers.
PART II

CONTRACTS WITH AMERICAN DISTRIBUTORS AND SALES AGENTS;
INTERNET SELLING TO THE U.S. MARKET

- **Your Products and Services.** Make sure that your products and goods can be lawfully imported into the USA, that all legal requirements of U.S. customs and import laws are met, that you have all required licenses and permits to import and sell the products, and that your export and import documentation complies with U.S. law. Most of the points in the preceding sentence apply to services as well.

- **Trademarks; Other Intellectual Property.** If you intend to sell goods or services to the USA under a particular trademark, brand name, promotional slogan etc., have your U.S. lawyer check, before you start business, whether the use of the mark, name, slogan, etc. might infringe any existing trademark. If it does not, consider applying for U.S. trademark protection covering that mark, name, slogan, etc. That applies for the USA and any other Western Hemisphere countries in which you may wish to market your products or services. Essentially the same points apply to other types of intellectual property you may have and should protect (e.g., patents, copyrights and designs), though the application procedures for each type and the nature of the rights conferred are different.

- **What Are They and What Do I Want.** Be sure you understand the differences between a “distributor” or “dealer”, and a “sales agent” or “sales rep”. Decide carefully which you want for the U.S. market.

- **How Many?** Think through carefully whether you want to have one exclusive distributor, dealer, sales agent or rep for the U.S. market, or several of them. If several should be the answer, should each have exclusivity for a particular part of the USA or should they all be non-exclusive for the entire USA? There is no one pattern that will suit each and every company. A good market study may be a worthwhile expense.

- **“Due Diligence”.** Check out your prospective U.S. distributor(s), dealer(s), sales agent(s) and sales rep(s) in advance, before engaging them. There are several areas you should check. These include their legal status, financial situation and banking information/references. Your U.S. lawyer can obtain for you at a relatively low cost valuable information about your prospects. Too many non-U.S. companies rush into deals with U.S. parties without doing a proper “due diligence”, and the result is often a messy affair.

- **The Drafting Initiative: A Critical Point.** You, the Indian party, should take and keep the initiative in drafting contracts and non-binding summaries of key terms (“NB- SOTs”). Try your level best not to let your eventual U.S. contracting party submit the first or any later contract draft, or any NB-SOT. Insist that the U.S. side comment on your NB-SOTs and contract drafts rather than submit its own drafts. The “drafting initiative” is a critical element in arriving at what, from your standpoint, is a “good contract”. Remember, the distributor, dealer, sales agent or rep will want a short contract that places on it few obligations, with a
long duration and severe restrictions on your right to terminate, no or low minimum targets to meet, excellent payment terms, no security for payment, and disputes resolved in the U.S. party’s “back yard” under that U.S. state’s laws. You, the supplier, will want essentially the opposite, and you should insist on it. After all, they are your products! See below regarding the NB-SOT.

- **Importance of First Class Contracts; Reducing Risks of Lawsuits.** The importance to you, the Indian supplier, of properly drafted, first class contracts for the U.S. market, is paramount. They will help you to attain what you want, and to avoid pitfalls, potential claims and lawsuits. Also, if you do have an actual or potential lawsuit, a signed contract that has been properly drafted, protecting your interests, will give you certain key advantages. First class, U.S. style contracts are your first line of defense, and one of your primary assault weapons. Many lawsuits arise in the USA precisely because of poorly drafted contracts, oral contracts, contracts established by letters or memos, or “de facto” contracts, particularly where non-U.S. parties are involved. It is better to incur legal fees to prepare contracts and related documents properly, at the outset, than to pay the probably much higher litigation costs (plus, of course, the potential damages and losses).

- **“NB-SOT”**. Very often, it makes good sense to begin formal negotiations not with a contract draft, but with a non-binding summary of key terms (“NB-SOT”) prepared by your side (with the aid of competent counsel). Some call it “letter of intent”. There are important strategic and tactical advantages of commencing with a NB-SOT.

- **Partial List of Important Points for Distributorship and Dealership Contract:** This list of important points is not meant to be complete nor are the points presented in any particular order.

  1. **Contract Products:** These should be clearly defined. If, during the course of the agreement, you develop other products, should they automatically fall under the contract?

  2. **Sales Territory; Exclusive or Non-Exclusive Rights:** These points must be clearly articulated in the contract. The contract should clearly define what is meant by a sale by the distributor or dealer within its specified territory. Where the territory is large (e.g., all of USA, Canada and Mexico, or even all of the Western Hemisphere), you may wish to grant exclusive rights for part of it and non-exclusive rights for other parts. You may wish to reserve certain customers in the agreed territory for direct sales by you, the Indian supplier.

  3. **Sales To Only Specified Type of Customers:** You might wish to confine the distributor’s or dealer’s sale of your products to a particular type of customer (industry segment) or to customers who will use your products only in a particular way.

  4. **Can the Distributor or Dealer Appoint “Subs” and Sales Agents?** Should the distributor or dealer have the right to appoint sub-distributors or sub-dealers, and/or sales agents or sales reps? If yes, can that be done only with your (supplier’s) prior written consent? Should you attach to the distributorship contract a model of such agreements that the distributor or dealer must use?
5. **Sales Outside of Territory or Outside of Permitted Scope:** Those points should normally be dealt with in the contract. There is, for example, American case law holding that if the contract does not clearly prohibit it, a distributor or dealer can lawfully sell outside of its assigned territory.

6. **Duration:** Will the contract be for a fixed term (with or without an option to renew) or of indefinite duration? Either way, there should be termination clauses. See point 19 below regarding “termination”.

7. **Delivery Terms:** These should be clearly set forth, and you should know exactly what the delivery terms mean and what rights/obligations flow from them. Specific delivery terms (e.g., FOB, CIF, C&F) carry with them certain consequences, unless the parties agree by contract to vary them. If there will be variations (e.g., when title or risk of loss passes to the buyer), they should be set forth in the contract.

8. **Payment Terms:** The method and time for payment, including provisions for interest on late payments, should be set forth. If payment (in whole or in part) will be by letter of credit, the l/c terms must be carefully drafted.

9. **Security for Payment:** If you will be selling on credit terms, what security for payment will you receive? One very frequently used U.S. mechanism is the “security interest” which operates basically the way a real estate mortgage does and can give you a “secured creditor” position in the agreed “collateral” of the distributor or dealer. The “collateral” under a “security interest” can be any present or future non-real property assets of your buyer. It is one of the most commonly used security mechanisms in the USA. For more about the “security interest”, you may wish to consult one or more of the publications listed in the Appendix.

10. **Minimums Quotas:** If you are granting the U.S. side exclusive or quasi-exclusive rights for all or part of the USA (or North America), you will normally want the U.S. distributor or dealer to agree to “minimum quotas” which, if not met, will entitle you to terminate the agreement. From your standpoint, minimum purchase quotas (the distributor’s or dealer’s purchases from you) are better than minimum sales quotas (the distributor’s or dealer’s sales to its customers). Sometimes, even when the distributor or dealer has only non-exclusive rights for its territory, minimums may be desired. **Minimum quotas are only effective if properly drafted, there being many points to cover to reach that goal.**

11. **Promotional Moneys:** Will there be an agreed minimum budget for promoting your products in the distributor’s territory? As between the distributor or dealer and you, the supplier, which will contribute what portion? Of course, the permitted types of promotion should usually also be specified in the contract.

12. **Sales/Promotion Under What Mark or Name?** As a general rule, the supplier’s trademark, brand and/or other distinguishing characteristics (for short, “trademark”), rather than the distributor’s or none, should appear prominently on the products and/or their packaging and be used to promote them in the contract territory.
Otherwise, the supplier will not build up brand recognition in the marketplace and may lose the customers once the distributorship contract ends. When the supplier’s trademark(s) will be so used, the contract should so state and should contain special clauses designed to protect them.

13. **Adequate Stock:** Will the distributor or dealer be required to maintain a stock of the supplier’s goods, and if so, at what level?

14. **Sales on Consignment:** Yes, under U.S. law, you can sell on consignment, but experience has shown that it is a risky practice in terms of getting paid, recovering your goods and for tax reasons. You should consult competent U.S. counsel in advance if you are thinking about consignment sales.

15. **“Acceptance”:** Sometimes, distributorship arrangements involve machinery or equipment that the U.S. distributor will resell to customers, who will use them in their plants or factories. In arrangements of this type, the distributor’s customer will normally want to have a start up and initial trial test and then condition final acceptance of the goods on a final acceptance test. Provisions dealing with those points, including defining parameters for acceptance, should normally be built into the contract.

16. **Clauses Designed to Reduce the Indian Supplier’s Product Liability and Late Delivery Risks:** These types of clauses, including limitations on the supplier’s express warranty on the contract goods, require careful thought, negotiation and drafting. See the next Part regarding “product liability”.

17. **Competitive Restrictions on Distributor or Dealer:** Certain types of contractual restrictions on distributors or dealers may violate U.S. “antitrust” law. These can include price fixing, minimum price levels, territorial restrictions, non-compete clauses, “tying”, and other restraints. Avoiding antitrust violations or even allegations thereof is essential, because a party allegedly injured by competitive restrictions can sue for and, if successful, recover 3 times the damages sustained, plus attorneys’ fees and costs. With careful drafting, the Indian supplier may be able to achieve its business goals while minimizing the risk of such claims.

18. **Avoid Having a “Franchise”:** Unless what you really want is a franchisor-franchisee relationship (or to grant a “master franchise”), avoid falling into the trap that your distribution, sales agency, license or other agreements can be characterized as “franchise” arrangements under U.S. law. Franchises are often subject to an entire level of regulation that you might wish to avoid. Competent U.S. counsel will provide guidance in this area. Just by way of example, certain computers software licenses and authorized reseller agreements may fall within the ambit of U.S. federal or state franchise legislation, with actual or potential negative consequences for the licensor. See, in that regard, Part IV of this Guide.

19. **Termination Provisions; Improper Termination Claims; Related Points:** There should normally be a number of provisions allowing the supplier, or either party, to
terminate the contract on several different grounds, including, in many instances, without cause. These must be carefully negotiated and drafted. Not infrequently, terminated distributors, dealers, sales agents and reps attempt to claim damages for improper termination. With skillful drafting, that risk can usually be reduced, if not eliminated. Similarly, the contract will usually state what happens upon or shortly after the contract’s termination or expiration. Among them, the supplier will often want either the obligation or the right to repurchase the distributor’s or dealer’s remaining stock of goods. The supplier might also want the right to take over some or all of the sub-distributorships and sales agency/sales rep contracts that the distributor has entered into for the supplier’s products.

20. What Tribunal Decides Disputes/Claims and What Law Applies? How you deal with these questions in your contract are vital “business” points, not just legal ones for the lawyers to work out. That statement merits strong emphasis. Consider this writer’s “general rule”: you, the supplier, should be able to attack (bring your claims against the U.S. side) in the USA via arbitration under particular American Arbitration Association (“AAA”) rules in a U.S. city not too close to the U.S. party’s place of business but reasonably convenient for you; and to defend (the U.S. side brings claims against you) via AAA arbitration in the same location as just mentioned or, alternatively, in a Indian city or a city in a third country reasonably convenient for you, under acceptable, specified arbitration rules. How these points are resolved will vary from case to case, according to the facts and circumstances and what can be negotiated.

21. Tax Aspects: When arranging your U.S. export sales and contracts, be careful to avoid having a “permanent establishment” in the USA or a “fixed base” in the USA from which you render “independent personal” services. These are tax concepts found in the US-Indian income tax treaty.

- Sales Agency and Sales Rep Contracts for the U.S. Market. A number of the points made above will apply here, but with adaptations here and there. Unlike distributors and dealers that buy and resell goods, sales agents and reps do not buy and resell, but rather obtain customer orders for the supplier’s goods (the sales being between the supplier and the customer). Here are a few other points applicable to sales agents and sales reps:

1. Commission, Rate and Basis: These terms must be carefully negotiated and drafted. On which sales does the agent or rep earn its commission and at what point in time? If you have more than one sales agent or rep for the USA, there is the potential for territorial customer overlaps. Who earns what commissions on which sales are questions that should be resolved in advance by contract.

2. Agent or Rep Accepting Orders: Avoid allowing your agents or reps having or exercising the power to accept orders for your goods, and deal with that point specifically by contract. Allowing any of your agents to accept orders can result in tax and legal problems for you. You, the supplier, should be the only one to accept (or decline) orders.

3. Advances: If you plan to allow your agent or rep to receive advances against future commissions, the contract should be very clear that these are advances to be repaid within a specified time—even if earned commissions do not equal the advances.
4. **Rep or Sales Agent as Your Employee:** If the sales rep or agent is an individual, take care that he/she is not characterized as your “employee”. Simply writing in the contract that he/she is not your employee will probably not do the trick. A foreign company will not want to have any U.S. employees soliciting orders within the States. If one or more sales reps or agents are, in fact, likely to be viewed as your employees, and if you cannot alter that situation, you should consider forming a U.S. subsidiary and having those individuals be employees of the sub.

- **Computer Software Licenses and Authorized Reseller Agreements.** See the end of Part IV for a few comments on these subjects.

- **Internet Selling into the U.S. Market.** This expansive subject can only be dealt with very briefly in this short Guide, mentioning only a few points.

  1. Some U.S. states (e.g. California) have enacted rather strict laws applicable to what must appear on websites, particularly, rather a fairly detailed privacy policy and statements regarding site visitor’s and customer data; spam; and the like.

  2. Many non-US website sellers place terms and conditions of sale (“GTS”) or the like on their site that are intended to be legally binding on the purchaser. Very often, those GTS are not beneficial to the seller-----they do not fit, legally and practically. Those GTS should be modified to be suitable and protective of the seller, for the USA and essentially all other country markets the site will reach. See the Appendix for Mr. Wise’s guide on GTS.
PART III

PRODUCT LIABILITY IN THE USA

• **Proper Perspective of the Risk.** Do you have a realistic, informed view of the product liability risk in the USA as it applies to your particular goods? Or do you have an unrealistic, exaggerated, media-influenced viewpoint? While there is a product liability risk for many Indian firms, it will normally be manageable if you adopt certain measures. In short, if you are concerned about product liability, educate yourself about the risk and what you can do to reduce and manage it. An unwarranted “knee-jerk” reaction shouldn’t frighten you away from the U.S. market.

In the opinion of this practicing American lawyer, these concerns are typically exaggerated, blown out of proportion, and do not reflect the realities. American product liability judgments awarding exorbitant damages—including ones that seem to impose liability for no good reason—are very rare. These rarities are, however, fodder for the media.

Just as important if not more so, there is a recent, major trend under way to reform the American product liability legal regime. The trend is likely to continue and extend its reach. These developments are definitely pro-business and quite significant, for manufacturers, sellers and others in the chain of bringing products and goods to the market. That includes foreign ones, their US subsidiaries and joint venture entities. The trend could possibly in relatively short order reach the proportions of a “product liability law revolution”. Arguably, it already has! See particularly the Guide “American Product Liability:…” mentioned at the end of this Part and in the Appendix.

That does not mean, however, that foreign (e.g., Indian) companies and their US subsidiaries should not seriously adopting various measures to reduce their US product liability risk. They quite probably should.

• **Who Can Be Sued? Who Can Be Liable?** Stated in a general way, anyone who designs, manufactures, sells, distributes, or renders services in connection with a product, or component or part thereof, can incur product liability in the USA. That may include a licensor of technology used to produce the item or of a trademark or brand name (if the product is marketed with that mark or name). A plaintiff often tries to sue all parties in the distribution chain. That does not mean, however, that the plaintiff will succeed against all of them, or succeed at all.

• **Important Jurisdictional Point: Your Company May Not Be Subject to the Jurisdictional Reach of the Particular U.S. Court in Which a Product Liability Suit Is, or May Be, Brought.** You may at the very least have a good legal argument supporting that point and that in itself may deter the plaintiff from suing or continuing suit. That may apply even if you have a U.S. subsidiary or affiliate engaged in the sales or distribution process. We use the word “may” intentionally—the preceding three sentences will not necessary apply to all Indian parties in each and every instance. But they probably will apply to a considerable number. If you want more information about this very important point, you might consult the source cited at the end of this Part.
• **Passing and Reducing Risk by Contract.** A significant part of your product liability risk can, by contract, be passed on to your U.S. customer, distributor, dealer, licensee or joint venture partner, and be reduced in other ways by contract. Even properly drafted and implemented “General Terms of Sale” tailored to the U.S. market can reduce your risk.

• **Another Liability Area.** Liability can arise when your buyer, typically a legal entity, allegedly sustains losses and damages as a result of defects in or deficiencies of your products, equipment, etc. Damages due to your unexcused late delivery might also come into play. The alleged damages might include your customer’s plant down time, lost profits, other economic damages, penalties your buyer might incur to third parties, and other possible direct and consequential damages. The plaintiff might also attempt to claim punitive damages. The risks associated with this type of liability can be very substantially reduced by including or not including certain provisions in the contract with your buyer. The term “contract” can also include “General Terms of Sale”-see the preceding point.

• **Indian Contract Documents Probably Won’t Do The Trick.** You should not assume that contract documents prepared according to Indian law or in any manner other than by competent U.S. counsel will accomplish the goal of reducing and helping manage the U.S. product liability risk. The likelihood is that they will not.

• **Product Liability Insurance.** You should seriously explore the possibility of purchasing product liability insurance and commercial risk insurance for the U.S. (and possibly Canadian) market in appropriate amounts. You should normally require your U.S. contract partner (e.g., distributor, licensee) to carry and maintain an acceptable level of product liability insurance covering the goods you sell to that partner. Sometimes, it makes sense to try to convince your U.S. contract partner (e.g., distributor, licensee, joint venture partner) to include you as a co-insured under its policy or policies, with you reimbursing the U.S. side for the additional premiums. Even with reasonably good insurance coverage, it will normally be prudent to consider implementing various other measures designed to reduce the risk.

• **If You Are Sued or Suit is Threatened.** If you are contacted by a plaintiff (actual or potential) or the plaintiff’s lawyer regarding an actual or potential product liability suit against you, do not reply, orally or in writing. Rather, you should contact your U.S. lawyer, who will advise you what to do. Sometimes, your lawyer will prepare a reply for you to make. Not infrequently, the lawyer for the potential plaintiff will send you and request that you sign and return a document by which you waive service of process or allow service of process to be made upon you by a simplified route (e.g., mail). You should not comply, for normally, the plaintiff, in order to effect valid service of process against a Indian company, might have to go through a tedious, formal procedure that can take several months. The fact that the plaintiff may have filed a Complaint with a particular American court does not mean the court has obtained jurisdiction over you---as one element, the plaintiff must effect a legally valid service of process against you and file proof of that with the court.

For more details on product liability, see the list of Guides in the Appendix, in particular: *American Product Liability: “Good News for Business!” Recent Trends and Developments; and American Product Liability: Can Managers and Executives Be Held Personally Liable?* Both are available at no cost from the writers. See also the Appendix to this Guide.
PART IV

LICENSING, TECHNOLOGY TRANSFER AND INTELLECTUAL PROPERTY
IN THE USA

• The Meaning/Pros and Cons of Licensing. In practical, non-legal terms, licensing means granting to someone the right to use, normally for commercial purposes, certain intellectual property. A non-exhaustive list of the types of intellectual property that can be licensed are: patents, trademarks, internet domain names, copyrights (including computer software), trade secrets and know-how. Except for computer software, the license will normally permit the licensee to produce or manufacture or have produced or manufactured, in whole or in part, particular products or components, to assemble them (where applicable), and to sell them in an agreed territory. In most instances, the licensee is granted the agreed rights for a specified time period; or, alternatively, the agreement will have no fixed term but can be terminated by the licensor (or both parties) for specified causes or without cause. Typically, the licensee will agree to make certain payments for the rights granted (and possibly for services the licensor will render). The term “technology transfer”, in the American context, has no specific meaning. It is mentioned only because in some circles the term is loosely used. There are positive and negative features of selecting licensing as a way of doing business in the USA. You should be well aware of them before deciding to embark on the licensing path.

• Protecting Your Intellectual Property. The Indian party’s intellectual property to be licensed should, to the extent possible, be registered (or filed, as appropriate) or at least applied for, in the USA (and where applicable, in other Western Hemisphere countries). That should, whenever possible, be done prior to negotiating the license agreement. You, the licensor, are likely to negotiate a better deal in that posture. Trade secrets and know-how are not filed or registered with any governmental agency.

• “Due Diligence” Review of Licensee Candidates. You should do a careful due diligence review of each licensee candidate. That will include reviewing the prospect’s financial and legal condition, its capability to produce the licensed products, and its ability to market them expeditiously in the contractual territory. Your U.S. lawyer can assist you in obtaining certain important information regarding licensee candidates and evaluating them.

• License Agreements for the U.S. Market. For the licensor’s protection and benefit, there is no substitute for a carefully drafted license agreement prepared by an American lawyer experienced in that field. Without that, the results can be a failed deal; placing your intellectual property rights at risk; a legal dispute or an actual lawsuit; and unnecessary expense. Most properly prepared license agreements for the U.S. market will be rather detailed, complicated and fairly lengthy, and not easy to negotiate. The reason is that there are a considerable number of points to be covered, negotiated and drafted.

• The “NB-SOT”. As with any other contract, it is often useful not start with a draft license agreement, but rather, with a non-binding summary of key terms (“NB-SOT”) as the first negotiation document. Your U.S. lawyer, with your input, will bring an NB-SOT to the point where both of you are satisfied with it and are ready to submit it to the licensee.
• **The Drafting Initiative.** You should do your utmost to seize and retain the drafting initiative both for NB-SOTs and contract drafts. To the extent avoidable, you should insist on the U.S. side only commenting on yours. Losing the drafting initiative can make it difficult to conclude a binding license agreement on terms that are advantageous to you. Also, once the potential licensee has submitted its draft, it is difficult, and often more expensive, to reformulate it to satisfy your concerns.

• **Competitive Restrictions on Licensee: Potential Illegal or Dangerous Terms.** Certain competitive restrictions imposed on a licensee and certain other contractual terms may 1. violate the U.S. federal or state antitrust or analogous laws; and/or 2. where you are licensing U.S. patent rights, be a patent misuse and put your patent at risk. Moreover whether or not there is an actual violation or misuse, a poorly drafted or inappropriate restriction can lead a licensee to bring or threaten to bring a legal claim or counterclaim against you, typically to retaliate when you sue or try to terminate the license. A party who successfully pursues an antitrust claim can collect treble damages, actual damages times three. Also, the court can award the winner its legal fees and costs. Experienced U.S. counsel will know how to draft the agreement to minimize this type of risk.

• **Exclusive Licenses; Non-Exclusive Licenses.** As a general rule, nothing prohibits an exclusive license covering all of the USA. Like all general statements, there are a few exceptions. But the general rule will apply to most Indian companies. Sales by a licensee outside of its territory can lead to problems that – while thorny – can be solved. The granting of one or more non-exclusive licenses will not normally pose any problem under U.S. law.

• **Clauses Protecting Licensed Trademarks.** Under U.S. law, an agreement licensing or permitting a third party to use a trademark should contain certain clauses designed (among other things) to protect the licensor’s rights in the mark. Without such clauses, the licensor’s trademark may be jeopardized.

• **Royalties; Up-Front Payments, etc.** With few exceptions, the licensor and licensee can freely agree on the royalties, including, where applicable, an up-front payment (payment upon the license agreement being signed or very shortly thereafter). The same applies for minimum royalties, which the licensor will often want. The “few exceptions” just mentioned are points about which you may wish to question your U.S. lawyer.

• **Trade Secret and Know-how Licensing and Protection.** These can be licensed, and in general, clauses prohibiting the licensee’s unauthorized use and disclosure during the contract’s term and after the contract ends are enforceable, at least if the technology is not in the public domain. With a clear contract, even technology or knowledge that is not secret at the time of contracting, or ceases to be, can be the subject to royalty or similar payments. That is, with concise drafting, the licensee will not usually be able to convince a court that it can stop paying because the licensed technology or data is in the public domain or is known to all competitors. U.S. courts grant strong protection to trade secrets and proprietary data. In appropriate circumstances, U.S. courts will issue injunctions to protect trade secrets and other proprietary information. Under the arbitration rules of the American Arbitration Association, arbitrators too can issue preliminary and final injunctive-type orders.
- **Sale of Intellectual Property.** Instead of licensing the right to use for a limited time period, it is possible to sell outright intellectual property. In the case of trade secrets and know-how, the sale can be confined to the rights for a particular country or territory (e.g., the entire USA, or the USA and Canada). The tax aspects of intellectual property sales should be examined carefully.

- **Choice of Tribunal and Choice of Law.** These points are not just “legal points for the lawyers and of secondary importance to the economics of the license deal.” They are very often critical business-legal points. What the agreement states on these points can be crucial for the licensor if it wishes to consider attacking, for example, if the licensee does not pay the agreed royalties, abuses or steals the licensor’s intellectual property or engages in some other wrongdoing. When the licensor may be defending a claim by the licensee (for example, for the licensor’s alleged breach of contract or a product liability or similar claim), what tribunal located where will decide the claim under which law is of paramount importance. Review these issues in detail with experienced U.S. counsel, arrive at the best solution and fall back position, and attempt to negotiate the most favorable provisions on these points.

- **Tax Aspects.** The Indian licensor should, with the aid of experts, examine in advance the tax ramifications of the particular license or other intellectual property deal. Among other sources, the U.S.-Indian income tax convention should be consulted. As a general rule, an Indian party should do everything possible to avoid having what that tax convention defines as a “permanent establishment” in the USA or a “fixed base” used for the rendering of independent personal services in the USA. U.S. state and local taxes, such as sales and use taxes, may also be relevant.

- **Clauses Often Difficult to Negotiate and/or Draft in License Agreements.** Here are a few examples (without much explanation given here):

  1. When exclusivity will be granted for only a part of the USA and that will be the licensee’s entire contractual territory, the issue of under what conditions the licensee can sell the licensed products in other parts of the USA.

  2. Royalty clauses, particularly: A. Up-front payment; B. minimum royalties; C. running royalties: the percentage, the base on which they are calculated, when they accrue and when they are payable.

  3. Improvements or modifications of the licensed technology or licensed products made:

     A. by the licensee: To whom do they belong? What rights therein should the each party receive? B. by the licensor: Are they part of the licensee’s rights? What if the licensor’s improvement is a “major development”?

  4. Infringements of the licensed intellectual property rights by third parties: which party has which obligations, if any, to prosecute infringers and under what terms and conditions?
5. If the licensed products infringe the intellectual property rights of a third party, how will the license agreement deal with that?

6. The duration of the license agreement, and in particular, the termination clauses. One especially tricky issue relates to the licensor’s right to terminate should the licensee enter into bankruptcy proceedings.

7. Others mentioned above.

- **Computer Software Licenses and Authorized Reseller Agreements.** A great many of the points made in this Part and in Part II of this Guide apply, either directly or with some adaptation, to computer software licenses and authorized software reseller agreements. Parts XIII (Litigation and Arbitration in the USA) and XIV (Errors Frequently Made by Non-US Parties) also contain relevant points.

Here are a few points pertinent to such agreements for the USA not specifically covered in those other places:

1. **U.S. Franchise Laws:** There are federal regulations applicable to “franchises; and U.S. state legislation governing “franchises.” Frequently, a software license even more so, a software reseller’s agreement can constitute a “franchise” for purposes under the federal and certain state franchise legislation. The consequences thereof can be negative, even grave, for the licensor. Many of the franchise statutes define quite broadly what is a “franchise”. It is not possible in this short guide to discuss this subject in detail. Citing just one example, New Jersey’s franchise act captures, as a “franchise”, many software licenses and especially authorized reseller agreements. That act prohibits the licensor (franchisor) from terminating or modifying the “franchise” agreement without good cause, defined in the act, and lists a number of other no-no's----violations. That act accords the injured or potentially injured franchisee a number of remedies, from injunctive relief, to damages, including possible punitive damages, recovery of its legal fees, to even possible reinstatement. Attorney-author Wise has been involved with several cases of this type.

2. **Improper Termination by Licensor:** Even if the software license or reseller’s agreement does not constitute a “franchise” under state franchise legislation, some U.S. states will require “good cause” for franchisor termination; and/or will require a sufficient notice period to the licensee especially where the termination is without cause.

3. **Poorly Drafted Software Licenses and Reseller Agreements:** It occurs rather frequently that software licenses and authorized reseller agreements drafted by foreign (non-US) companies and their local advisors are just not well drafted or are not suitable for the USA or risk violating US law.. Frequently, they also do not offer sufficient protection to the licensor. Preparing the agreements properly for the US market may involve some costs to the licensor (including legal research by US counsel), but its risks outweigh those costs.

4. **Policing the Agreement:** Not infrequently, the licensor does not require the licensee or reseller to comply with certain of its contractual obligations, or the licensor itself does not comply with certain of its own obligations. When the time comes that the licensor wants to terminate the agreement, such non-compliance can pose a potential problem or obstacle.
5. Trademark protection: Sometimes, the licensor does not bother to register its trademark(s) in the USA, Canada and other important markets (e.g., Mexico or South American countries). The licensee becomes aware of that and decides to register the one or more of those marks in its own name, without informing the licensor. The licensee then has an important bargaining chip to ward off a potential licensor termination, or to obtain better contract terms, or a payout on licensor’s termination, for the licensor to get back its trademark rights. The licensor might well be able to challenge at the Trademark Office level or in court, the licensee’s registration, but may be reluctant due to the costs.

For more details on licensing, technology transfer and intellectual property, see Chapter 9 of Aaron N. Wise’s “A Foreign Business Person’s Guide to American Law - Business Practices - Taxation”, available at no cost from him.
PART V
DIRECT INVESTMENT OUTSIDE INDIA BY INDIAN COMPANIES:
A LEGAL AND REGULATORY PERSPECTIVE

A. Introduction

Here, we are dealing with investments in Joint Ventures (“JV”) and Wholly Owned Subsidiaries (“WOS”) abroad by the Indian party. In particular, the main focus is the Indian requirements for setting up a JV and WOS in the United States. You qualify as an “Indian party” if you are a company incorporated in India or a body created under an Act of Parliament, making an investment in a JV or WOS abroad (e.g., in the USA); or any other entity in India so designated by the Reserve Bank of India (“RBI”). An Indian party can also include an Indian partnership, a resident individual, and certain other types of Indian resident persons.

You, the Indian party, would typically enter into a JV with an entity formed, registered or incorporated in accordance with the laws and regulations of the USA in which you would make a direct investment. However, the JV vehicle could be one formed, registered or incorporated in essentially any foreign country.

There are many reasons to set up a US JV or a US WOS. You may want to have a presence in the market; to satisfy existing customers and prospects; to manufacture, process or assemble products in the States; to protect against liability claims; and to minimize certain tax or customs duty-related costs.

You, the Indian party, are legally permitted to make direct investments outside India by way of contribution or promise to subscribe to the capital of a US entity. That does not include portfolio investment or investment through a stock exchange or via private placement in the US entity. The Reserve Bank of India has also notified that no Indian party shall make any direct investment in a US entity engaged in real estate business or banking business.

B. CATEGORIES OF DIRECT INVESTMENT OUTSIDE INDIA

There are various categories in which you, the Indian party, could make an investment outside India (e.g., in the USA).

• Automatic Route

An Indian party may invest in a US JV and/or in a US WOS by submitting form ODA, duly completed, to a designated branch of an Authorized Dealer, in an amount up to 100% of the Indian party’s net worth as of the date of its last audited balance sheet.

The above investments include the Indian party’s contributions to the capital of the US JV/WOS, loans granted by it to the JV/WOS, and 50% of the guarantees issued by it to or on behalf of the JV/WOS. These investments are subject to the following conditions:

(a) You, the Indian party, may extend a loan or guarantee to a US entity in which you have equity participation.
(b) You cannot be on the RBI’s caution list, or under investigation by its Enforcement Directorate, or a defaulter under the Indian banking system by appearing in the Defaulters’ List published/circulated by the RBI. Authorized Dealers may, while allowing remittances under the Automatic Route, satisfy themselves that you are proposing to make the investment and are not included in the Defaulters’ List. If your name appears in the Defaulters’ List, you should apply to the RBI for prior approval for purposes of the US investment.

(c) You should route through a branch of an Authorized Dealer all financial transactions relating to the US JV/WOS.

In case of partial/full acquisition of an existing US company, where the investment is more than USD 5 million, valuation of the shares of the company must be made by a Category I Merchant Banker registered with the Stock Exchange Board of India (“SEBI”) or an Investment Banker/Merchant Banker outside India, i.e., one located in the US that is registered with the appropriate US regulatory authority and in all other cases by a US CA/CPA where amounts are below USD 5 million.

However, in every case of investment by way of a swap of shares, irrespective of the amount, valuation of the shares will have to be by a Category I Merchant Banker registered with SEBI or with an US Investment Banker registered with the appropriate US regulatory authority. As a precondition, you will also have to seek approval of the Indian Foreign Investment Promotion Board (“FIPB”).

At present, Indian residents are not permitted to make investments in the equity (capital) of companies registered in the USA except by way of setting up joint ventures or wholly owned subsidiaries.

The Reserve Bank has announced relaxations in respect of US investments as under:

I) Corporates

A Listed Indian party is permitted to invest in US companies that:

(a) are listed on a recognized stock exchange and;

(b) own at least 10 percent of the shares of an Indian company listed on a recognized stock exchange in India (as on 1st January of the year of the investment). Such investment may not exceed 25 percent of the Indian company’s net worth as of the date of its latest audited balance sheet.

II) Individuals

Indian resident individuals are permitted to invest in US companies indicated at (I) above without any monetary limit.
Note that the RBI has now accorded general permission to Indian corporates to invest within the respective ceilings as applicable, in rated bonds/fixed income securities. The rating should be at least A-1/AAA by Standard & Poor or P-1/AAA by Moody’s or F1/AAA by Fitch IBCA etc. for short term obligations and corresponding ratings for long term ones.

- **The Above Relaxations Are Subject to the Following:**
  
  a) All transactions must be routed through a designated Authorized Dealer and rupee payments received out of the investor’s bank account.

  b) Before allowing the remittances, the Authorized Dealer must ensure that the investments are made strictly in accordance with the conditions stipulated above. That means investments in securities of companies listed on recognized stock exchange abroad and that such companies in turn have at least a 10 percent share holding in an Indian company listed on a recognized stock exchange in India.

  c) Authorised Dealers shall retain with them full particulars of investments such as names/addresses of the investors, companies in which the investments are made and details of securities held.

- **Companies in Which US Investment Is Not Permitted by an Indian party**

  An Indian party is not permitted to invest in the following types of US companies:

  1. Listed US companies where subsidiaries are holding a 10% or more stake in listed Indian companies;

  2. Listed US companies where investment is through a Special Purpose Vehicle (SPV);

  3. Listed US financial funds holding a 10 percent or more stake in a listed Indian company.

- **Investment in Agriculture by an Indian party**

  At present, Indian resident corporates and registered partnership firms are permitted to invest in agricultural activity in the US, including purchase of land incidental to this activity, only through a Joint Venture (JV)/Wholly Owned Subsidiary (WOS) in the US within the overall limit available for investment overseas under the Automatic Route. To repeat, that is up to 100 percent of their respective net worth, subject to reporting in form ODR.

- **Investment in the US Financial Services Sector by an Indian party**

  You, the Indian entity engaged in the financial services sector and wishing to make investment in an entity engaged in the financial sector activities in the US, must meet the following conditions:
a. be registered with the appropriate regulatory authority in India for conducting the financial sector activities;

b. have a net profit for the preceding three financial years from the financial services activities;

c. have obtained the prior approval for your financial sector investment activities from both the competent Indian and American regulatory authorities; and

d. fulfilled the norms relating to capital adequacy as prescribed by the concerned regulatory authority in India.

When forwarding their remittance report on form ODR to the RBI, Authorized Dealers may also forward details of regulatory approvals.

• **Investment in the US by a Partnership Firm in India**

If you are a partnership firm registered under the Indian Partnership Act, 1932, engaged in the bona fide business activity, and have a good track record, you can lawfully invest in a US JV and/or a WOS in the US by submitting form ODA to a designated branch of an Authorized Dealer. This, however, is subject to the rule that such investment must not exceed 100% of your firm’s net worth, subject to other terms and conditions laid down under the automatic route. Note that individual partners may hold shares for and on behalf of your firm in a US JV and/or a WOS in the US if US regulations or operational requirements warrant such holdings.

• **Investments in the US by a Proprietary Concern in India**

If you are a proprietary concern in India you may apply to the Reserve Bank (on Form ODB) for general permission which, if granted, is valid for one year, to accept shares of a US company in lieu of fees due to you for professional services rendered to that US company. That is subject to the following provisos:

(i) the value of the shares accepted from the US company does not exceed 50% of the fees owed by the US company to the Indian party from the US company; and

(ii) your concern’s shareholding in any one US company by virtue of shares accepted cannot exceed 10% percent of that US company’s paid-up capital.

• **Investment under Swap or Exchange of Shares Arrangement**

If you, the Indian party, are already engaged in any activity involving an American Depository Receipts (“ADR”)/Global Depository Receipts (“GDR”) issue, you may acquire shares of US companies engaged in the same core activity in exchange for ADRs/GDRs issued to the latter in accordance with the scheme for issue of Foreign
Currency Convertible Bonds and Ordinary Shares (through the Depository Receipt Mechanism Scheme 1993, and the guidelines issued thereunder from time to time by the Indian Central Government). To do so, you must comply with the following conditions:

1. The ADRs/GDRs must be listed on any stock exchange outside India;

2. Such investment by the Indian party:-
   a. does not exceed US$ 100 million, or
   b. The ADR and/or GDR issue for the purpose of acquisition is backed by underlying fresh equity shares issued by the Indian party;
   c. The total holding in the Indian entity by persons resident outside India (i.e., in the USA, for example) in the expanded capital base, after the new ADR and/or GDR issue, does not exceed the sectoral cap prescribed under the relevant regulations for such investment;

3. You (the Indian party) must report such acquisition on form ODG to the RBI within a period of 30 days from the date of the transaction.

4. Note that Authorized Dealers must also submit to the RBI the details of transactions such as number of the shares received/allotted, the premium paid/received, the brokerage paid/received etc. Additionally, they must also confirm that the inward leg of the transaction has been approved by the FIPB; that the valuation has been done as per established procedure; and that the overseas company’s shares are issued/transferred in the name of the Indian investing company. Authorized Dealers may also obtain from the applicants an undertaking that future sale/transfer of shares so acquired by non-residents in the Indian company will comply with Notification No. FEMA 20/2000-RB dated May 3, 2000 (as amended from time to time).

- **Approval of the RBI**

   In all other cases of direct investment in the USA not covered under the Automatic Route above, RBI’s prior approval would be required. For this purpose, applications together with documents should be made on Form ODB if the investment is for acquiring shares of the US company engaged in the same core activity in exchange of ADR/GDRs issued to the latter in excess of USD 100 million or ten times the export earnings (whichever is higher)/Block Allocation/or acquisition of shares of a company outside India in lieu of fees due to it for professional services rendered to the said company.

- **Form ODI in All Other Cases.**

   The RBI would take into account the following factors (among others) upon considering such applications:

   (i) Prima facie viability of the Joint Venture/Wholly Owned Subsidiary outside India (e.g., US JV or WOS in the USA);
(ii) Contribution to external trade and other benefits which will accrue to the Indian party through such investment;

(iii) Financial position and business track record of the Indian party and the US entity;

(iv) Expertise and experience of the Indian party in the same or related line of activity of the JV or the WOS outside India (e.g., in the USA).

- **Acquisition of a US Company Through Bidding or Tender Offer Procedure**

If you are considering acquiring a US company, you may remit an earnest money deposit or issue a bid bond guarantee for acquisition of the US company through bidding and tender offer procedure, and also make subsequent remittances through an Authorized Dealer, subject to the following norms:

1. On being approached by an Indian party eligible to make investment in the US, an Authorized Dealer may allow remittance of an earnest money deposit or issue a bid bond guarantee on the Indian party’s behalf for participation in the bidding or tender procedure;

2. Upon the Indian party winning the bid,

   (i) the Authorized Dealer may allow further remittances towards the acquisition of the US company, subject to the ceiling specified as above under the Automatic Route and;

   (ii) the Indian party must submit through the Authorized Dealer a report to the RBI on Form ODA within 30 days of effecting the final remittance.

3. For participation in the bidding or tender offer procedure for acquisition of a US company not falling under (1) just above, the RBI may, upon application on Form ODI, allow remittance of foreign exchange of an earnest money deposit or permit the Indian Authorized Dealer to issue a bid bond guarantee, subject to such terms and conditions as RBI may stipulate.

4. In case the Indian party is successful in the bid but the terms and conditions of acquisition of a US --

   (a) are not in conformity with the above norms or different from those for which approval under (3) just above was obtained, the Indian party must submit an application to the RBI on Form ODI for approval of the foreign direct investment, or

   (b) do comply with the above norms or are the same as those for which approval under (3) just above was obtained, the Indian party must submit a report to the RBI giving details of the remittances made within 30 days of effecting the final remittance.
• **Post investment Changes/Additional Investment in Existing JV/WOS**

A properly established US JV/WOS in the US established may diversify its activities/set up step down subsidiary alter the shareholding pattern in the overseas entity subject to the Indian party reporting to the RBI the details of such decisions. The report must be submitted within 30 days following the approval of those decisions by the US governmental authority concerned of such JV/WOS under US law. The information must also be included in the Annual Performance Report that the Indian party must prepare and submit each year to the RBI.

• **Obligations of the Indian Party**

Once you, the Indian party, have made a direct investment in the USA, you must:

(a) receive shares certificate(s) of the company (e.g., US company) or any other document evidencing the investment,

(b) repatriate to India the amount due you from the US entity; and

(c) submit the documents/Annual Performance Report to the RBI every year within 60 days from the date of expiry of the statutory period as prescribed by the respective laws of the US for finalizing the audited accounts of the US JV/WOS in the US (or such further period as may be allowed by the RBI); and such other reports or documents the RBI may require.

• **Pledge of Shares**

As an Indian party you may pledge the shares of a US JV/WOS in the US to an Authorized Dealer or a financial institution in India in order to obtain a credit facility for yourself or for the American JV/WOS. If, of course, you are contractually bound not to pledge your shares (e.g., by a Shareholders’ Agreement or provision in the US company’s bylaws, or the like), then you cannot do so unless you obtain the requisite approval of the other shareholders of your US JV.

• **Hedging of Overseas Direct Investments**

Resident entities having investments in the US are permitted to hedge the exchange risk arising out of such investments. Authorized Dealers may enter into forward/option contracts with Indian residents who wish to hedge their US direct investments (in equity and loan), subject to verification of such exposure and provided further that the contract is completed by delivery or rolled over on the due date.

If a hedge becomes naked in part due to market value shrinkage of the overseas direct investment, the hedge may continue to the original maturity. Rollovers on the due date are permitted up to the market value as on that date.
PART VI

CREATING A U.S. SUBSIDIARY TO SELL OR MANUFACTURE IN THE USA

Here, we are dealing with setting up a wholly owned U.S. company, not a U.S. entity with two or more shareholders which, broadly viewed, is a joint venture. Part VIII of this Guide deals with joint ventures in the USA. There are many reasons to set up a wholly-owned U.S. company. You may want to have a presence in the market; to satisfy existing customers and prospects; to manufacture, process or assemble products in the States; to protect against liability claims; and to minimize certain tax or customs duty-related costs.

- **What Not To Do.** You, the Indian enterprise, should **not** engage directly in U.S. business by opening a U.S. office in the Indian company’s name; by having a stock of goods in the USA owned by the Indian enterprise (or placed “on consignment” with an American distributor or dealer); by having employees of the Indian enterprise physically present in the USA taking orders for goods or services; open a US showroom in the Indian enterprise’s name where its goods are displayed and offered for purchase; or perform longterm service or construction contracts in the States; or by having a U.S. sales agent of the Indian enterprise with power to accept orders for the Indian firm’s goods or services. These are examples only. **In the overwhelming majority of cases of this general type, the Indian enterprise should, for legal and tax reasons, form a separate U.S. legal entity to carry out those (and certain other) activities.** See below regarding which type of U.S. entity to utilize.

  - Nor should the Indian enterprise utilize the “branch” form, that is, formally register itself in one or more U.S. states as a branch. **The legal and tax consequences of being a formally registered branch or the unregistered equivalent, will typically be negative.** Certain foreign banks and insurance companies do utilize the formally registered “branch” form, but those are exceptions pertinent to those types of business.

- **Legal Form.** What legal form should most Indian parties use for their U.S. business? The answer for most Indian parties is a “corporation”. There is no such thing as a U.S. corporation per se. Each of the fifty states has its own laws governing the creation of legal entities, corporations included. So, in the case of corporations, there are Delaware, New York, Florida, California, Illinois, etc. corporations. When this booklet refers to “U.S. corporation”, it means one formed under the laws of a U.S. state. A U.S. corporation offers the feature of limited liability to its shareholders (limited to their respective capital contribution). The limited liability company (“LLC”), while offering the limited liability feature, is, for legal, tax and cost reasons, usually not the appropriate vehicle for non-U.S. parties.

- **Which U.S. State?** Under which U.S. state’s laws shall I form my corporation? The answer will vary depending on the particular company’s needs. In most cases, though, the choice, in this writer’s view, will come down to: 1. a Delaware corporation; or 2. a corporation formed under the laws of the U.S. state in which the corporation will have its center of operations (e.g., main office).
• **Registering in Another State or States.** If I form my corporation in one U.S. state, then operate my business in one or more other U.S. states by accepting orders for goods and services within that or those other states, do I have to register my corporation to do business in that or those other states? The answer is generally, yes. Certain other activities that your corporation carries on or performs in U.S. states other than the one in which it is formed may require its registration to do business there. That registration process is not difficult, time consuming or expensive. Note, however, that the mere fact your corporation sells its goods from one American state to a customer in another American state does not normally require the corporation to register to do business in the customer’s state.

• **Corporate Name.** Is the name of my corporation formed in one state protected in all of the other U.S. states? The answer is no. But that usually does not present any serious problem. Even when it does present a problem, it can generally be satisfactorily resolved.

• **Corporate Name and Trademark.** A corporate name is not the same thing as a trademark. A registered U.S. federal trademark will provide protection throughout the entire USA for the particular goods or services for which it is registered. The corporate name of your U.S. corporation will give you (weak) protection within the state in which the corporation is formed, and in those other states in which the corporation is registered to do business. But the protection offered by a corporate name is far from, different, and much weaker than, the protection accorded by a U.S. federal trademark. Thus, an Indian enterprise will normally want to obtain U.S. federal trademark protection for the name, brand, logo, or other designation used in connection with the products or services it will be marketing in the States.

• **Minimum Capital.** Is there any “minimum amount” of capital I have to put into a U.S. corporation? In most states, there is none; and the minimum is very low in those states that specify one. That means that you are essentially free to decide on the amount of capital you want to contribute. In some situations, it may make tax sense to split the total invested dollar amount into an equity piece and a debt piece. Property or services can usually be contributed as capital (but, under some states’ laws, only past services rendered, not future services, can be contributed).

• **Nationality or Residence Requirements.** Non-U.S. nationals can own all of the shares of a U.S. corporation. There is no requirement that a U.S. citizen or permanent resident own shares. Nor must a member of the corporation’s Board of Directors or corporate officers own any shares. Similarly, all of the members of the U.S. corporation’s Board of Directors and all of its officers can, if so desired, be non-U.S. nationals and U.S. non-residents.

• **One Shareholder.** There is no problem with a U.S. corporation being owned by just one shareholder.

• **Par Value and No Par Value Shares.** It is common to issue “no par value” shares, rather than shares having a par value.

• **Board Members’ Powers and Related Points.** Members of the Board of Directors (called “directors”) are not directors in the Indian or British sense of the term. In the U.S. meaning, directors are simply members of the Board. The Board acts and decides as a body; individual directors have no power to act or to bind the corporation individually (unless, exceptionally,
by resolution or power of attorney, the corporation grants a particular director certain powers). Under the laws of many U.S. states, a one person Board is possible. Some states have a different rule when a corporation has two or more shareholders. Directors can be officers and officers can be directors.

- **Required and Optional Officers.** Many, if not most, U.S. state laws require a corporation to have a President, a Treasurer and a Secretary. Other officer posts are optional (examples: one or more Vice Presidents or an Assistant Treasurer). The officers’ respective powers (and limitations thereon) will typically be contained in the corporation’s bylaws and/or in a Board resolution.

- **Restricting Powers of Corporate Officers.** The powers of corporate officers can be restricted or expanded in the corporation’s bylaws, by contract or special Board (or shareholder) resolution. However, a third party without knowledge of restrictions on the officer’s powers may not be bound by them.

- **Is a Corporate Officer or Director of a U.S. Corporation Its Employee?** No, not merely from serving as such. If it is clearly agreed that the officer or director is an employee of the corporation and he/she is on the corporation’s payroll, then yes. But, for example, it is not at all unusual to have a President, Vice President, Treasurer, Secretary or other corporate officer who is not an employee of your corporation. Often, your U.S. lawyer will serve as the corporation’s Secretary, but he or she will normally not be its employee.

- **Tax Returns If Corporation Inactive.** Yes, the corporation must file tax returns even if it generates no income or is inactive.

- **Lawyer in One State Forming Corporation Outside That State.** An experienced corporate lawyer located in one U.S. state will have no difficulty in forming a corporation (or any other type of U.S. legal entity) in another U.S. state.

- **Time.** It takes only a short time to form a 1 shareholder U.S. corporation in any U.S. state from the time your lawyer has received all of the information required. But it does take time to do the preparatory paperwork properly.

- **Corporate Bank Account(s).** The setup of one or more bank accounts for the corporation is often done by your U.S. lawyer. That can often be a surprisingly lengthy, complicated procedure.

- **Manufacturing in the USA.** Here are a few things that will have to be done:

  1. Decide where in the USA to manufacture. Negotiate with the state and local authorities for incentives and benefits (e.g., tax breaks, reduced power costs).

  2. Decide whether to build a new or existing building for the plant or to lease it; decide whether to buy or lease the land; and how these operations will be financed.

  3. Decide what equipment will be needed for the plant, whether it should be purchased or leased, and how to finance the operations.
4. Hire employees, deal and negotiate with a union, if any; and train employees.

That short list is very far from being complete. One comment regarding point 1 is appropriate. Legal and tax factors or incentives offered by particular U.S. states should not be your primary reasons for deciding where to locate your production facility. Other, more practical factors resolving themselves into one trite phrase should prevail: “Where does it make the most practical business sense to locate my production facility?”

- **Getting the Corporation Running: Legal Work.** Apart from forming the corporation, there is usually a litany of other legal and tax work involved in getting the corporation to the point of conducting business. Other Parts of this guide deal with some of them.

For more details on forming a U.S. company and manufacturing in the USA, see Chapter 7 of Aaron N. Wise’s “A Foreign Business Person’s Guide to American Law - Business Practices - Taxation”, available at no cost from Mr. Wise. See also the Appendix to this Guide.
PART VII
DEALING WITH EMPLOYEES: OVERVIEW OF SOME MAJOR FEATURES OF U.S. LAW AND PRACTICE

This subject if treated in detail could occupy many pages. There are a great many aspects and each of them has many different features and ramifications. Only one of the reasons for that is that employment law is, in part, state law and thus will in some respects vary considerably from state to state.

Some aspects relating to employees and employment law have been treated in other Parts of this guide. By way of example, see Part XII regarding U.S. visas for Indian (and other foreign) employees of your U.S. operation. We will not reiterate those points here.

In this Part we do not treat the subject of dealing with U.S. labor unions and U.S. federal law applicable thereto, which falls under the general rubric “labor law”. Rather, we focus on a few key aspects of U.S. employment law and practice.

- **Employment Contracts; Employee Secrecy and Non-Competition Agreements.** It is normally advisable to conclude written employment contracts, American style, with key employees of your U.S. subsidiary or JV company, such as its executives, officers and key technical managers. One reason is obvious: to define the terms and conditions applicable to their employment; and often, to limit their capacity to act and bind the employer, e.g., without the prior written approval of the employer’s board of directors or owners. Another important reason is to protect the U.S. company and its Indian parent company against claims by the employee, for example, claims of improper termination when the employment relationship ceases. Claims and lawsuits concerning “improper termination” of employees, based on one legal theory or another, are relatively common in the USA. With a good employment contract prepared by experienced U.S. counsel and proper conduct by the employer, it will usually be possible to avoid or at least substantially reduce the risks of such claims. From the company-employer’s standpoint, it is normally preferable that only the U.S. subsidiary or JV company (the employer) sign and be legally bound by thereby---not the parent company or JV company’s owners; and that the employment contract so state. Sometimes, however, the employee will insist on the written guaranty of the parent company or JV owners of the U.S. subsidiary’s or JV company’s obligations under the employment agreement. And sometimes the parent or JV owners will not mind at all guaranteeing said obligations. In the employment contract, the law of the particular U.S. state where the employee will primarily perform his/her services should usually be specified as applicable, unless that law is particularly unfavorable to the employer, in which case, to the extent legally possible (and in many instances, it may not be possible for purposes of the desired effect), the law of another, more favorable U.S. state should be specified.

The employment contract should contain either an arbitration clause providing for arbitration in the USA (typically, under the American Arbitration Association’s pertinent rules) or a clause specifying a particular U.S. court to resolve disputes and claims. Some U.S. states’ laws will not permit arbitration of certain employment disputes, and a point to be checked before preparing the agreement.
All that being said, they must be considered in light of the remaining points of this Part that follow.

- **Termination Without Cause; Termination for Cause.** Some U.S. states, perhaps the majority, follow the common law “at will” rule that absent an agreement to the contrary, an employee can be terminated at will by the employer without cause without liability for improper termination. For example, New York State falls in that category. However, even U.S. states in the “at will” category have fairly recently developed exceptions to that norm. For example, if there is some company handbook stating or policy or practice to the effect, that employees will not be terminated without cause or only upon a certain minimum notice period, a court may apply that even if a written employment contract stating otherwise exists. Some U.S. states go to the extent of virtually prohibiting an employee from terminating an employee without cause except where parties reaching written agreement at the time of termination or thereafter on additional compensation to the employee.

The employment agreement should state the grounds for termination for cause, which can also include events like the closing of the U.S. company, its sale etc.

The main point is that prior to concluding any employment contract with a key employee, the employment law of the particular U.S. state(s) concerned must be taken into account for purposes of how the agreement should be drafted. Moreover, prior to the employer’s termination contemplated termination of any employee, with or without cause, U.S. counsel should be consulted. The same applies where the employee quits of his/her volition or terminates.

- **Employee Confidentiality and Employee Invention Agreements.** The U.S. employer company should seriously consider having essentially all of its officers and employees, not only key ones, sign secrecy agreements. They would typically contain non-disclosure and non-use obligations on the employee with respect to the secret and otherwise proprietary data (technical, commercial, client lists etc.) of the U.S. company and its parent or JV owner(s), return or destruction of all company files and materials, etc. It might also contain provisions dealing with inventions, discoveries, improvements and the like developed by the employee while employed and possibly even a certain period thereafter (ownership thereof, patent and other rights, whether the employee is entitled to any additional compensation). If written employment contracts are concluded with particular employees can be built into them. If no employment contract will be concluded, then a secrecy/invention type agreement might well be in order.

- **Post-Employment Non-Compete Clauses.** Most employment contracts with employees will prohibit the employee from working for any other person or firm while in the employer’s employ (sometimes, there are exceptions made, e.g., where the employee is not full time in which case normally, the employee will be prohibited from working for a competitor of the employer). Normally, such clauses will pose no significant legal problem. Much more tricky, and problematic, are “post-employment non-compete clauses”----that is, a prohibition upon the employee, once his/her employment ends, from working in a particular field whether for a third party or for his/her own account. The enforceability of post-employment non-compete clauses will vary from U.S. state to state. In some U.S. states, it will be very difficult if not impossible to enforce them. In other states, they will have to be very carefully, precisely and narrowly drafted to stand a reasonable chance of being enforceable (e.g., by way of injunction, damages for breach): they will have to be reasonable in time, scope, geography and not unduly restrict the ex-employee’s ability to earn a living in his field.
- **Discrimination and other Unlawful Acts by Employer.** U.S. state and federal law prohibit essentially any form of discrimination by the employer against the employee. Also prohibited more or less throughout the USA are sexual harassment in the workplace; and retaliatory firing or demotion by the employer where, for example, the employee blows the whistle or threatens to do so regarding some illegal action by the employer. There is American legislation requiring the employer to retain a woman’s job while she is on maternity leave, and while a person is serving in the military. There are many different types of employer acts which U.S. law will regard as unlawful or which an employer must comply with which cannot be mentioned in this Guide.

- **Employer Handbook or Similar Document.** It is generally a good procedure for the U.S. subsidiary or JV corporation to have an employee handbook or similar document stating its policies and procedures applicable to employees and employment; and to update it regularly. Competent U.S. counsel can assist in preparing it.

- **Proper Payment of U.S. Taxes and Other Withholdings.** The employer should be sure that all amounts required to be paid to the U.S. tax authorities by the employer (e.g., by way of withholding) are paid in on time. In a small U.S. operation one should not leave it to the employee to see that that is done; rather, a bookkeeper for the U.S. company or a commercial payroll company should take care of that.

- **Employee Pensions and Profit Sharing Plans; Certain Other Employee Incentives.** U.S. law does not require enterprises to offer pension or profit sharing plans to employees. Careful planning is required where such benefits are contemplated. On occasion, the employer offers a particular employee the opportunity to acquire or purchase shares of stock or ownership interest in the U.S. company. In such case, written agreements are necessary regarding such acquisition or purchase, including provisions on restriction on the employee’s transfer of shares, cash-out or buyout provisions and a plethora of others.

- **Agent, Consultant or Independent Contractor: Is He or She Really an Employee?** It frequently occurs that a particular enterprise will engage an individual as its sales (or other agent, a consultant or as an independent service-rendering contractor. At least that is the intention. However, it can easily occur that such person, from a tax and/or legal perspective, really meets the requirements of an “employee” and will be so treated. Most commonly, that occurs once the relationship is cut with that person. He/she will claim to be an employee for federal and/or state unemployment compensation, social security, workers compensation or other purposes, and claim that the employer, e.g., did not make the required payments and owes the employee money. Or, the federal or state authority will make such claim. Prior to engaging such person, competent advice should be sought.

- **Employees of the Foreign Parent or Foreign JV Owner(s) Working in the USA.** For legal and tax reasons, foreigners, that is foreign companies and individuals, should, as a rule, not have employees of their own working in the United States. There may be some valid exceptions to this general rule, where such employees function in the USA for a short time on a project basis, or performing limited services.

- **Smaller U.S. Operations of Foreign Companies: Proper Controls and Monitoring.** It occurs not too infrequently that a foreign company places one, perhaps two persons, in charge of
running its U.S. subsidiary. But, it does not maintain proper control over or monitor those persons’ acts. Such persons might be American, or might be brought in from abroad. There are either no proper contracts with such persons or poor and incomplete ones. The persons are not required to report and account on a regular basis to the company’s Board or owners, financially or otherwise; and may not do so. Sometimes, they are wrongly permitted to hire U.S. company’s legal counsel, accountants and other experts, or the foreign parent accedes to those persons’ recommended experts being hired. Whereas, the foreign parent should select them, and they should be totally independent and loyal to the foreign parent, not to the U.S. company or any of its employees. Those experts should be eyes and ears of majority owner. Runaway employees can wreck a small U.S. operation. Your American lawyer-author has seen it happen more than once. Once such a problem presents itself, the foreign owner is typically in a bind: it is reluctant to dismiss the runaway employee because it has no one else to run the U.S. operation and finding someone is difficult and will take time. It will try to bring the runaway into line, but not infrequently, it does not succeed but allows the situation to continue until it is forced to shut down the U.S. company. Proper planning and action from the start reduce the risks of this occurring.
PART VIII

JOINT VENTURES IN THE USA

• **The Right Partner.** JV’s for the U.S. market will work only if you have the right partner(s). Check out each JV candidate carefully in advance of any deal. Your U.S. lawyer can obtain valuable data for you about the candidates that you probably cannot obtain elsewhere.

• **Most U.S. JVs Not Permanent.** Nor should you view them as permanent -- or even, in many instances, as long term arrangements. Circumstances, people and mentalities change. Try to arrange your U.S. JV and your planning so that if the JV breaks up at some point, you can continue the U.S. operation.

• **U.S. Corporation as JV Vehicle.** Rarely should a foreign party participate directly in a U.S. JV or “cooperation agreement”. Direct participation in an “unincorporated JV” or “cooperation arrangement” will expose the foreign party to potential liability for the venture’s debts and liabilities, to lawsuits in the States, and to negative tax consequences. As a rule, from the Indian partner’s standpoint, a new U.S. “corporation” should be the JV vehicle. There may, of course, be instances in which another form of U.S. legal entity, like the limited liability company (“LLC”), would suit the purpose. Normally, however, a foreign party should avoid using an LLC, for legal, tax and cost reasons.

• **Three Typical Types of U.S. JV:**
  1. **Distribution JV:** Indian and U.S. parties form a corporation under the laws of a U.S. state (very often, Delaware), each owning an agreed percentage (the “JV Corp”). Typically, it will be the Indian side’s products that the JV will sell, and a distributorship contract will be among the JV documents to negotiate/sign. If the U.S. side will also be selling goods or products to the JV Corp, the terms will normally be embodied in a separate agreement. Typically, the U.S. side will contribute U.S. marketing knowledge, a sales force (its own or independent agents/ reps), technical knowledge about the JV products, and possibly things like administrative assistance and the use of its physical facilities. The JV Corp will sell the products to customers in its agreed territory (e.g., the entire USA, and possibly elsewhere in the Western Hemisphere).
  2. **Production JV:** It is similar to the distribution JV except that the JV Corp will manufacture (in whole or part) and/or assemble the products emanating from the Indian side (and, where applicable, those coming from the U.S. side), and resell them. The U.S. side may have a production facility which will be used to make the JV Corp’s products, or the JV Corp may buy or lease an existing one or build a new one. Manufacture may take place in the USA, or even in Canada, Mexico or elsewhere in the Western Hemisphere. Among the contract documents to conclude is a “license agreement” from the appropriate JV partner to the JV Corp allowing it to manufacture its products with the partner’s technology or other intellectual property.
  3. **R&D JV:** An Indian and a U.S. party form a U.S. entity to engage in research and development or similar activities.

• **Importance of First Class JV Contract Documents.** This is a must, especially for the foreign (e.g., Indian) side. To the extent possible, all the transaction documents should be signed at essentially the same time.
“NB-SOT”. Rather than proceeding directly to contract drafts, it is usually advantageous to commence negotiations by preparing, honing to your and your U.S. counsel’s satisfaction, submitting to the U.S. side, and working to the signature of, “a non-binding summary of key terms” (“NB-SOT”) of the deal. That technique has many benefits for both sides.

**Drafting Initiative.** Repeating the same thought made several times in this booklet, you, the Indian side, should do your utmost to seize and retain the drafting initiative throughout, regarding both NB-SOTs and contract drafts. Let the U.S. side comment on your documents. The importance to you of the “drafting initiative” should not be underestimated.

**Tax Planning.** Proper tax planning for a U.S. JV, with the assistance of experts, is important. It may affect the JV structure negotiated and implemented.

**Some Key JV Points to be Negotiated (Non-Exhaustive List):**
This listing of only a few examples presumes that the JV vehicle is a U.S. “corporation”.
1. Under which U.S. state’s laws will the U.S. JV corporation be formed?
2. What type(s) of shares the JV vehicle will issue and what percentages will each side have therein?
3. Capital contributions to JV vehicle of each partner; capitalization of the JV corporation generally. How will future capital increases or loans be handled if the corporation needs additional funding?
4. How will members of JV vehicle’s governing management body (“Board of Directors”) and its officers be selected and who will they be?
5. What are the functions and powers (and restrictions thereon) of each of the JV corporation’s officers?
6. What acts, binding documents, etc. of the JV corporation require the prior approval of the JV’s shareholders and/or Board of Directors? Will there be a special majority or unanimity required for certain acts and activities of the JV corporation?
7. Deadlock situations and how to deal with them contractually.
8. What will be the restrictions on transferring shares of the U.S. JV corporation? Buyout obligations? Options to purchase or sell? First refusal provisions?
9. Provisions for terminating the JV and dissolving the JV corporation.
10. All of the key provisions in any distributorship, license, employment, loan, service, employment, or other agreements between or among the JV partners and the JV.
11. Provisions dealing with how and where disputes and claims will be resolved, and what laws will apply to the JV contracts.

**Input of Indian Client and its Indian Lawyer.** The Indian partner and/or its Indian lawyer (or other advisor) will have to work closely with its U.S. lawyers to put together and close a U.S. JV. That input and cooperation is vital.

**U.S. Corporation with More Than 1 Shareholder.** Whether or not called a JV, if there will be more than 1 shareholder in a U.S. corporation, what will be needed (at a minimum) is (i) a shareholders’ agreement between the parties; and (ii) special Bylaws of the U.S. corporation tailored to the shareholders’ agreement’s provisions. As one example: an Indian company forms a U.S. corporation. Either at the time of formation or later, it decides that a particular employee or group of employees of the U.S. corporation can buy or otherwise obtain shares in it. When that happens, it will be necessary to prepare, negotiate and sign, at the very least, a shareholders’ agreement, plus special bylaws.
• **Costs.** It will normally cost considerably more in legal fees to create a JV than to form a wholly owned U.S. subsidiary.

For more details on U.S. joint ventures, see Chapter 8 of Aaron N. Wise’s “*A Foreign Business Person’s Guide to American Law - Business Practices - Taxation*”, available at no cost from Mr. Wise. See also the Appendix to this Guide.
PART IX
BUYING AN EXISTING U.S. COMPANY OR
A PART OWNERSHIP THEREOF

An entire, lengthy book could be written about this subject. It is a complex one, with many aspects, subtopics and perspectives. The magnitude of the acquisition and of the parties involved will affect the legal, tax, financing and other considerations. Smaller acquisitions will not normally be subject to the same complexities as larger ones. If the acquisition target is a public company (e.g., its shares are traded on a stock exchange), certain rules and regulations must be taken into account. The contemplated purchase of a minority interest in a U.S. company often generates issues not presented when an entire company or a majority interest will be acquired.

In this overview, it is not possible to discuss all or even nearly all of the ramifications of acquiring an existing U.S. company or an ownership interest therein. Rather, we can and do only focus on some of the pertinent points. And, they are presented only as a rather simplified overview, mainly for the non-lawyer.

LEGAL FORM OF THE ACQUISITION

There are, in general, three ways in which the acquisition of a company (the "Target Company") can be accomplished:

- you can form a U.S. subsidiary and cause it to merge or consolidate with the Target Company (statutory merger or consolidation);

- you can form a U.S. subsidiary and cause it to acquire all or a portion of the assets of the Target Company (assets acquisition);

- you can purchase all or a part of the shares of stock or ownership interests of the Target Company, either directly or through your U.S. subsidiary (stock acquisition).

! Statutory Merger and Consolidation

The laws (statutes) of virtually all U.S. states provide for and allow the merger of two corporations or their consolidation. These acquisition techniques can, of course, only be used where the purchase already has its own U.S. corporation (or other suitable U.S. legal entity) available to participate in the merger or consolidation. A U.S. entity, typically, a corporation, can be quickly organized for this purpose if the purchaser does not own one. Many, if not most, U.S. state laws permit statutory mergers and consolidations between and among corporations formed in different U.S. states.

! Statutory Merger

In a statutory merger, one corporation with all of its assets and liabilities, is merged into another corporation (the surviving corporation). After the merger, the merged corporation disappears and the other corporation is the surviving entity.
**Consolidation**

In a consolidation, two corporations consolidate all of their assets and liabilities, forming a new surviving corporation. Neither of the two consolidating corporations survive.

As distinguished from an acquisition of assets, the statutory merger has the advantage of greater simplicity. All assets and liabilities (including all contractual rights and obligations) are transferred to the surviving corporation by operation of law. This means, for example, that it will not be necessary for the merging company to sign numerous assignment documents for its various agreements and bills of sale for its assets. The statutory merger may offer certain important tax advantages for the seller.

Moreover, a statutory merger can often be consummated even over the protest of dissenting minority shareholders. Although the shareholders of both corporations involved in the statutory merger (or consolidation) must approve the transaction--in most U.S. states by a 2/3 vote of the outstanding share capital--generally the only remedy for dissenting minority shareholders is to have their stock appraised and then purchased at the appraised price.

One possible negative of a statutory merger or consolidation is that the surviving corporation will have assumed not only the assets and liabilities of the merged company or consolidated companies, but also any hidden or unknown liabilities. Even if representations and warranties against the existence of hidden or unknown liabilities are given by the merging or consolidating companies, they would normally not survive after the merger or consolidation. One possibility is to have the shareholders of the non-surviving corporations make such warranties and have them survive for an agreed time.

**Assets Acquisition**

In an assets acquisition, the buyer acquires all or certain defined assets of the Target Company. Among the potential advantages of an assets acquisition are:

- The buyer acquires only those assets of the Target Company that it desires.

- The buyer does not normally assume the obligations and debts of the Target Company, unless by contract the buyer agrees to assume all or some of them. In certain cases, however, where the buyer continues the same business as the Target Company with most of its employees, the Target Company ceases to function, and possibly other criteria are present, the assets purchasing entity may be found liable for certain of the obligations and debts of the Target Company.

- The assets buyer does not inherit any unwanted minority shareholders of the Target Company.

- Where the assets selling company survives the sale and is quite solvent, any representations and warranties made by it to the buyer in connection with the sale will, if the agreement so states, survive. Thus, any claims which might arise out of any misrepresentation or breach of warranty can still be asserted against the selling company after the consummation of the deal (depending, of course, what the assets purchase contract states).
Possible disadvantages of an assets purchase are:

- The buyer will normally not be able to obtain the benefits of the Target Company's existing contracts without the consent of the other contracting party (unless, for example, the contract permit the Target Company to assign without such consent).

- The assets buyer will not automatically acquire, and may not be able to purchase as separate assets, certain permits, licenses and government approvals granted to the Target Company.

- In an assets purchase agreement, each individual assets to be acquired must be segregated, described, and transferred. That can sometimes make for a long and tedious set of documents. Certain purchased assets, like patents, trademarks, and copyrights etc., will require special documents which must be filed with the corresponding authority (e.g., the U.S. Patent and Trademark Office).

- Many assets acquisitions will require compliance with state "bulk sales laws", that is, preparation of various forms/documents and their filing with the appropriate state authority. These laws are designed to protect creditors of the Target Company where certain types of assets are being transferred. Sometimes, the parties agree to not comply with those laws and make sure that the creditors are paid off.

- In certain situations, the seller may be reluctant to structure the deal as an assets purchase due to U.S. tax considerations. For example, the Target Company or its owners may be subject to tax on the gain from an assets sale. **As a general rule, for tax purposes, the buyer prefers to purchase shares of stock or ownership interests, not assets, and the seller prefers the converse.**

Let us return to a point already mentioned. The general rule is that the buyer of a Target Company's assets does not, under the laws of most U.S. states, assume or take over the obligations, liabilities and debts of the Target Company, unless the purchase contract otherwise states. **However, case law in some U.S. states and a few federal statutes and case law have carved out some important exceptions.** Roughly and generally stated, when the buyer carries on essentially the same business as the Target Company with the acquired assets and other elements (e.g., the Target Company's key personnel) and particularly, where the Target Company has been liquidated or rendered an empty shell, the courts of some states will hold the buyer liable for all or certain of the obligations, liabilities and debts of the Target Company. Product liability is just one type of claim where this principle can come into play. Also, in the area of environmental liability, under both federal statutes and many state laws, a new owner of a business or certain assets (e.g., land) will incur this sort of successor liability even if it does not carry on essentially the same business as the Target Company did or does.

It is important for the assets buyer to have its counsel research successor liability well in advance. Likewise, with respect to potential environmental liability; and in connection therewith, to have the appropriate environmental studies done prior to closing an acquisition of any type (possibly, before even signing the acquisition agreement). If the potential buyer decides to proceed to negotiate the deal, sufficient protection against these (and other) risks should be built into the acquisition agreement, from the buyer's standpoint.
Stock Acquisitions

When a company is acquired through the purchase of its stock, the parties to the acquisition agreement are the buyer and the selling shareholders. This is probably the most common form of acquisition, especially of privately owned corporations. A stock acquisition can be carried out in the following ways, generally speaking:

- private purchase of the shares of one or more existing shareholders;

- purchase of stock on a U.S. stock exchange;

- public takeover bid or tender offer, which can be either "friendly" or "unfriendly".

In any takeover of a U.S. company whose shares are publicly traded, the U.S. federal and state securities laws must be complied with. That also applies where the buyer intends to pay for the shares or assets of the Target Company with its own securities (e.g. stock).

It is worth emphasizing that a stock acquisition for cash is normally a taxable transaction for the selling shareholders. Thus, the buyer may have to pay a higher price to, in effect, compensate the seller(s) for those income taxes. And, in contrast to an assets purchase, the buyer of stock does not acquire a new depreciation basis for the Target Company's assets. Buyers, therefore, will generally want to purchase the Target Company’s stock or ownership interests, whereas sellers will usually push for an assets sale.

Some of the other potential advantages of a stock acquisition, mainly from the buyer’s standpoint, are:

- The essence of the deal is simply the sale of the stock by the existing shareholder(s) against cash and/or other assets. Neither the Target Company nor its assets or liabilities are in any way affected by the transaction. Thus, there is no need for any specific transfers or assignments of any of the US Target Company's contracts or assets (though the selling shareholder(s) will often represent and warrant that, in effect, the specific assets of the Target Company exist and are owned by it free and clear of all impediments except as otherwise stated).

- The buyer is normally dealing directly with the particular selling shareholders (at least in a private company acquisition) and there is, normally no legal requirement that shareholders approve the purchase by a shareholder majority.

- As distinguished from the statutory merger or the acquisition of assets, shareholders refusing to sell their shares have no appraisal rights, that is, no right to have their shares appraised and purchased at the appraised value.

- Since the acquired Target Company itself may not be a party to, or otherwise directly involved in, the stock purchase transaction, management of the Target Company has, except in a "tender offer" stock acquisition (described briefly below) no legal means of preventing or interfering with the stock purchase.

Some of the potential disadvantages from the buyer’s side are:
By a stock acquisition, the buyer indirectly acquires the company as a "going concern" with all its assets and liabilities. Thus, the buyer will indirectly acquire all of its undisclosed or hidden liabilities (e.g., environmental, product liability, other third party liabilities or claims, product recall expenses, tax liabilities). True, the buyer will normally protect itself against undisclosed or hidden liabilities by extensive representations and warranties and/or covenants of the selling shareholder(s), placing in escrow or holding back a significant part of the purchase price for an agreed time period to cover such liabilities. However, there is a risk that those measures may not be sufficient; or, that the selling shareholder(s) will not have the funds or will otherwise resist honoring their contractual obligations.

To the extent the buyer cannot persuade all shareholders of the Target Company to sell their shares to it (assuming the buyer wants to buy all shares), the buyer will have to live with one or more minority shareholders. There is at least some risk, especially if the buyer will be conducting various business operations with the Target Company, that the minority shareholders could object to some of them, including agreements between the buyer (or other of its related companies) and the Target Company, on the basis that they are not dealing "arm's length". In this same vein, minority shareholders may have certain rights by law that the buyer cannot avoid, and that could cause difficulties. One, but only one, possible problem is that one or more minority shareholders may be able to block the majority shareholder(s) from taking or not taking certain action.

DUE DILIGENCE; DRAFTING INITIATIVE; CLIENT DOING HOMEWORK AND BEING PATIENT

- **“Due diligence” is a must.** For any acquisition of a U.S. company, a considerable amount of preliminary homework will be required. All aspects of the acquisition target company will have to be carefully examined and evaluated, from top to bottom. This process is called “due diligence”. A due diligence review by your U.S. lawyers (a thorough review of the legal, tax and other aspects of the target company) which data will be supplied mainly, but not exclusively, by the target/its owners, is standard practice in the USA. Other types of experts will often be involved in the due diligence process, such as an accounting firm, an environmental study firm, or a construction engineer. Consummating an acquisition without proper “due diligence” is like “buying a pig in a poke”. If your experts’ due diligence reports reflect a company that is not to your liking, you might decide not to consummate the deal, or might bargain for better terms.

- **Drafting Initiative.** Through your U.S. counsel, you should do your best to prepare the first draft of the acquisition agreement (and any non-binding summary of terms or letter of intent that might precede it), and thereafter, to maintain the “drafting initiative”.

- **Do Your Own Homework and Be Patient.** Do not underestimate how long it will take to finalize an acquisition. Although the parties may have reached agreement in principle, it takes time to complete the “due diligence”, obtain the financing (where applicable), negotiate, prepare and revise the necessary contractual and other documents and get them signed, and do all of the other legal and non-legal tasks. You should not become exasperated because the acquisition agreement and other contractual documents are long and complicated. To get the best possible results, you should work very closely with your
U.S. counsel, review and comment on contract drafts and other documents, and generally, be part of a team.

TAX ASPECTS OF ACQUISITIONS

The U.S., foreign and international aspects of any acquisition should be carefully evaluated before entering into any deal. The U.S.- India income tax convention will often be an important tax planning tool. Other income tax conventions concluded by the USA and India may also come into play.

ACQUISITION FINANCING: SOME TAX CONSIDERATIONS

Here are a few points to consider:

! If the buyer intends to use external borrowing to finance the acquisition it might consider (i) placing the debt in a country in which the interest will generate the greatest tax benefit--usually a country with a high effective income tax rate; and (ii) using a U.S. holding company to place the loans, since if a consolidated U.S. tax return is filed by that company together with the acquired company, the interest expense of the borrowing company can reduce the acquired company's taxable income.

! If the buyer intends to finance the company internally, it might consider (i) use of intercompany, interest bearing loans to shift income outside of the USA; (ii) using a U.S. holding company to acquire a U.S. Target Company and capitalizing the holding company with part equity and part debt, thereby enabling the holding company, if a consolidated U.S. tax return is filed, to claim interest deductions offsetting the U.S. Target Company's post-acquisition income. There will normally be a lower U.S. withholding tax on interest paid by a U.S. holding company to its non-U.S. parent than on dividends.

There are, however, strict U.S. tax rules governing interest deductions between related companies, in particular, between a non-U.S. parent company and its U.S. subsidiary. These must be closely examined as part of the tax planning process.

STOCK ACQUISITION THROUGH TAKEOVER BID OR TENDER OFFER

Here again, these are complicated subjects about which only brief comments are offered.

! **Tender Offers**

Particularly where the shares of the US Target Company are held by a large number of shareholders, the prospective buyer may wish to consummate the share purchase through a so-called "tender offer". The tender offer is made directly to the shareholders of the US Target Company, frequently through prominent notices in one or more newspapers, though other means are also used.

A friendly tender offer is one where the attempted share purchase is supported by the management of the US Target Company. Typically, management will recommend in writing to shareholders that they accept the tender offer.
A hostile tender offer is one opposed by management. Management will frequently advise shareholders of its opposition, setting forth specific reasons.

U.S. companies, particularly larger ones, adopt certain measures to prevent hostile takeovers.

There are extensive legal requirements that must be met for "tender offers".

! Anti-Takeover Bid State Laws

Several U.S. states have enacted anti-takeover laws. Examples are Delaware, New York and New Jersey, though there are many others. While limitations of space do not permit a detailed, state-by-state discussion, or for that matter, any detailed treatment of this subject, two of these laws are very briefly discussed.

The New York law covers takeover bids (as defined) to acquire equity securities (essentially, voting stock) of New York target companies. Target companies include corporations organized under New York State law or those having their principal place of business and substantial assets in that State. When commencing a takeover bid, the offeror must file with the New York State Attorney General and submit to the target company a detailed registration statement. The Attorney General can investigate or conduct public hearings on the proposed takeover within a specified period after the filing, and give its ruling within a specified period. The Attorney General can prohibit the making or continuation of the takeover bid until the offeror complies with the law. There are criminal and civil penalties for violations.

New Jersey's law states, in very brief overview, that by a specified time before any takeover bid is made that might permit the offeror to acquire over 10% of the New Jersey target company's equity stock (including shares presently held by the offeror), the offeror must (i) file a rather detailed form with a particular State office and send a copy to the target company; (ii) file with that office a written consent to service of process in New Jersey; (iii) publicly disclose the material terms of the proposed takeover offer to leading wire services for the financial press; and (iv) not make a takeover bid without the consent of that office's chief (which may be after public hearings are held). Copies of essentially all advertisements, circulars, letters and materials issued by the offeror or the New Jersey target company soliciting acceptance or rejection of the takeover bid terms must be filed with that office, and must not be false or misleading. Violations of the law can result in criminal and civil penalties. The definition of a New Jersey target company includes a corporation formed under New Jersey law or one with its principal place of business in that State.

! Takeovers, Mergers and Acquisitions by Foreigners that Threaten U.S. National Security

A federal law permits the President of the United States or his designee to suspend or prohibit a takeover, merger or acquisition of a U.S. company by one or more foreigners ("foreign persons") if, in his view, the proposed transaction threatens national security. If the transaction has already been consummated, he may order the foreign person(s) to divest themselves of the U.S. company concerned. Regulations exist defining "foreign person" and "U.S. person"; and providing guidance as to transactions subject to that law and those not.
U.S. FEDERAL AND STATE ANTITRUST LAWS

Whenever Americans or foreigners (companies or individuals) plan a fairly large acquisition, takeover or merger in the States, they must notify the U.S. antitrust authorities of it and obtain a type of advance clearance from the U.S. federal antitrust authority. In capsule form, and with certain exceptions and nuances, the federal regulations on pre-notification are as follows:

<table>
<thead>
<tr>
<th>Value of the Acquisition or Merger</th>
<th>Pre-notification Required or Not</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than US$ 50 million</td>
<td>No.</td>
</tr>
<tr>
<td>Between US$ 50 million and US$ 200 million</td>
<td>Yes if one or the other side is of a certain size measured in general by the value of its assets and/or its net sales. Otherwise, no.</td>
</tr>
<tr>
<td>Above US$ 200 million</td>
<td>Yes.</td>
</tr>
</tbody>
</table>

If pre-notification applies and the requisite pre-notification documents are filed, the U.S. federal antitrust authorities have a certain time (waiting period) within which they can oppose the transaction or impose certain conditions in order for it to be consummated. The waiting period can be extended under certain circumstances, e.g., the authority requires additional information. If the waiting period expires without objection or imposition of conditions, the transaction, from a federal antitrust law standpoint, can be consummated.

Violation of the above rules, for example, the consummation of the deal before the waiting period expires, or after the authority has opposed it, or in violation of conditions it has set, or failure to file a complete and accurate notification, can give rise to the issuance of a compliance order and the imposition of very high civil fines.

U.S. Federal guidelines on acquisitions and mergers do change from time to time, thus for any particular transaction at a given time, review of the guidelines by competent counsel will be necessary.

An acquisition, takeover or merger can also be attacked after its consummation based on alleged violation of the U.S. federal or a particular American state's antitrust laws (many states have enacted antitrust or antitrust-type laws applicable to the market sector in their particular state). Regarding federal antitrust laws (and many state ones as well) the fundamental issue, generally stated, is whether the acquisition, takeover or merger substantially may reduce actual or potential competition in the sector concerned, or creates or tends to create a monopoly, or results in an unreasonable restraint of trade. The antitrust law of the particular U.S. state(s) concerned must also be reviewed for its applicability to the transaction and must be complied with, if applicable.

Also, any significant joint venture capable of affecting the U.S. commerce should also be examined in advance from a U.S. antitrust standpoint. Most of the points made above apply to joint ventures too. American antitrust authorities tend to treat joint ventures somewhat more leniently than acquisitions, takeovers and mergers.
Not only the U.S. government authorities, but third parties as well can attack mergers, acquisitions, takeovers, and joint ventures based on violation of the U.S. federal and/or state antitrust laws. They can, for example, attempt to sue for triple damages in certain instances.

Before any important acquisition, takeover or merger capable of affecting the U.S. market, the parties should consult their U.S. lawyers. They will review the proposed deal from an antitrust, and other important standpoints as well (by way of example, securities law requirements, environmental and tax considerations).

**TYPICAL STOCK PURCHASE OF A PRIVATELY OWNED U.S. COMPANY: KEY EVENTS**

Such a deal generally begins with negotiations between the potential buyer and potential selling shareholder(s) regarding the substance of the deal. During this stage, a great deal of financial, commercial and legal information/documents will have already been elicited from the seller(s) and are used as a basis for establishing the purchase price.

Often, as a preliminary step to the acquisition agreement, a legally non-binding letter of intent will be prepared and signed, setting forth major elements of the contemplated acquisition. It will, typically, serve as a starting point for preparing the acquisition agreement documents. In most cases, the prospective seller(s) will want the prospective buyer to sign a "secrecy agreement" because the latter will, in all likelihood, receive and learn confidential information of the Target Company.

The buyer must satisfy itself by means of a detailed audit and examination of the Target Company that the Target Company's situation (as set forth in the stock purchase agreement) is accurate (so-called "due diligence"). This process typically involves conducting a financial audit of the Target Company by an independent accounting firm; its physical assets checked by architects, engineers, and environmental experts; and its legal status and various legal arrangements and contracts examined by the buyer's U.S. lawyers. The "due diligence" procedures are sometimes completed before the acquisition agreement is signed; sometimes, after signature but in any case, prior to the "closing". In the latter case, the closing will be made contingent upon the seller(s) meeting certain conditions and the representations, warranties etc. they make in the agreement being true and accurate at the time of closing and, at least for certain of them, for an agreed time after closing.

If the "due diligence" processes reveal no serious or insurmountable irregularities, the acquisition agreement will be signed (unless signed prior to "due diligence" completion). The actual sale is consummated at a closing, at which the Target Company's purchased shares of stock are delivered to the buyer and the buyer pays the purchase price. Frequently, a portion of the purchase price (e.g. 20%, though it might be more or less) is not paid directly to the seller(s) but is, for example, withheld by the buyer or placed into "escrow" with a third party or the buyer’s or seller’s lawyer (typically, the buyer’s). That portion is held as security for the buyer against the appearance, after the closing, of undisclosed claims or liabilities arising out of the conduct of the company's business prior to the closing or its ownership/occupancy of land (e.g., environmental liability). Assuming no such claims or liabilities exhaust it, the portion of the purchase price withheld or escrowed will normally be released to the selling shareholder(s) over, e.g., a 2-3 year period, possibly in annual installments. In actual practice, many different
variations come into play, from case to case. These are only meant as relatively common examples.

THE STOCK PURCHASE AGREEMENT: SELLER'S REPRESENTATIONS AND WARRANTIES AND OTHER KEY TERMS

! REPRESENTATIONS AND WARRANTIES

The seller’s representations and warranties are among the most important provisions of the stock purchase agreement. In essence, they function as an extremely detailed description of the property, financial condition, agreements and business condition of the Target Company. The buyer relies on those representations and warranties in agreeing to purchase the shares of stock of the Target Company and to pay the agreed purchase price. A very general, conceptual idea of some of those clauses follows. I emphasize the word "some". The wording is not intended as a guide for how those clauses should or would be written. It is the concepts I am trying to illustrate. Also, these illustrations are focused mainly on a rather straightforward, rather uncomplicated, friendly acquisition of the shares of a privately owned Target Company. Naturally, each stock acquisition has its own features, and the provisions, including representations and warranties, will vary from case to case.

Seller hereby, severally and jointly, represent and warrant to the purchaser as follows:

! Corporate Standing and Powers

The Target Company is a corporation duly organized and existing under the laws of the State of (U.S. state of incorporation) and is in good standing thereunder. The Target Company is duly qualified (registered) to conduct business in all U.S. states where, in light of its present activities, such qualification is required. Copies of its Certificate of Incorporation, Bylaws, a Good Standing Certificate in its state of incorporation and in all states where it is qualified to conduct business, are attached as Exhibits ......hereto.

! Capital Stock

The issued and outstanding capital stock of the Target Company consist of ...shares of common, voting stock with a par value of $... each [or, e.g. common, voting stock without par value]. The present ownership of the capital stock is as follows:

<table>
<thead>
<tr>
<th>Name of Owner</th>
<th>Number of Shares Owned</th>
</tr>
</thead>
</table>

All shares of capital stock of the Target Company have been full paid, are non-assessable and are held free and clear of all liens and encumbrances.

! Financial Statements

Attached hereto as Exhibits..... are the balance sheets and the related profit and loss statements of the Target Company for the periods.....Such financial statements have been prepared in accordance with generally accepted accounting principles, applied on a consistent
basis, and present and true and complete statement of the financial condition of the Target Company as of their respective dates and its operations for the relevant periods.

! Title to Assets

Except as sold or otherwise disposed of in the ordinary conduct of its business since the date of the [latest] balance sheet attached hereto as Exhibit ..., the Target Company is the owner of and has good and marketable title to all the properties and assets tangible or intangible, reflected in said balance sheet, free and clear of all encumbrances [except as noted in ....].

! Condition of Buildings, Machinery and Equipment

The essence of this clause is that it assures the buyer that the buildings, machinery and equipment of the Target Company are in good repair/working order, and are free from any hidden defects, liens, encumbrances, etc.

! Accounts Receivable

By this provision, the seller will represent and warrant that the Target Company's accounts receivable, reflected in the latest balance sheet, have been collected or are collectable in the amounts shown.

! Inventories

In this provision, the seller(s) represent and warrant that the inventories shown in the Target Company's latest balance sheet are salable and usable, the valuation method used to reflect their value, etc. etc.

! Intellectual Property

If the Target Company owns any trademarks, patents, or other intellectual property, the seller(s) will represent and warrant such ownership and a complete schedule thereof (Exhibit) will be a part of the stock purchase agreement.

! Contracts and Unilateral Obligations

A list of all (or all material) contracts, agreements, promissory notes and other unilateral obligations and commitments of the Target Company will be an Exhibit to the stock purchase agreement. The seller will represent and warrant that complete and current copies, with all amendments, of all of those have been delivered to the buyer.

! Absence of Undisclosed Liabilities

The seller will normally represent and warrant that the Target Company has no undisclosed liabilities of any kind, that is, none other than those liabilities shown on the last balance sheet. A specific representation and warranty is also customarily made as the Target Company having no tax liabilities.
Often, as to potential environmental law liability that may arise after the closing but due to pre-closing conditions, the parties reach agreement covering several pages of text as to how that risk will be dealt with. That text may not be in the representations and warranties section of the purchase agreement, but be placed in a separate section and be worded as covenants, rather than representations and warranties. The same can apply, for example, to post-closing product liability or similar claims arising from the conduct of business prior to closing.

Absence of Litigation

There are no litigations, arbitrations, prosecutions, governmental actions, proceeding or investigations, pending, imminent or threatened against the Target Company or any of its officers, directors or shareholders (with any exceptions being noted in detail in a particular Exhibit or Exhibits).

Subsidiaries of Target Company

If the Target Company has any subsidiaries or affiliated companies that are being acquired through the purchase of the Target Company shares, then a number of representations and warranties applicable to those subsidiaries or affiliates will normally be required. The same will apply if the Target Company owns any participations (e.g. minority ownership) in any other firm or enterprise.

Correct and Complete Information Supplied

The seller will expressly represent and warrant that all information and documents supplied to the buyer are correct and complete.

As stated above, there will often be a litany of other representations and warranties that the seller will give the buyer. Also, the buyer will typically make certain representations and warranties to the seller(s).

The stock purchase agreement will typically also provide that the representations and warranties (or at least a great many of them) are made by the seller(s) both as of the date of signature of the agreement and as of the closing date; and may provide that they survive the closing for an agreed period of time. The survival of all or most of the seller(s)' representations and warranties for a sufficient long period after the closing is usually of critical importance for the buyer.

AGREEMENT TO BUY AND SELL SHARES AT CLOSING

Here are a just some of the types of provisions dealing with that subject, directly or indirectly. Again, I am attempting only to convey the sense, not how to word such provisions.

The seller agrees to sell and the buyer agrees to purchase the Target Company Shares [of stock] at the Closing on the Closing Date upon the conditions hereafter set forth. (All important terms, by way of example: "Target Company Shares", "Closing Date", must be clearly defined in the stock purchase agreement.).

Purchase Price; Holdback or Escrow Provisions
Such clauses will deal with e.g., what the total purchase price is, to whom it will be paid (e.g., if there are several sellers), the currency in which it will be paid, and when it will be paid (e.g. at the Closing). Where applicable, it will provide for the buyer holding back part of the purchase price or placing it in escrow (as discussed above). If a part of the purchase price will be paid at an agreed time or times after the Closing, the agreement will so state. The buyer might execute promissory notes for those deferred, post-closing payments.

Audit of the Target Company

Typically, the stock purchase agreement will state that by a certain date prior to the Closing, the Target Company will undergo an audit by a specified certified public accounting firm. Often, the buyer and seller(s) agree to divide the cost of the audit, 50%-50%.

Conduct of the Target Company's Business Until Closing

The selling shareholders will normally agree that until Closing, they will cause the Target Company to continue to engage in the normal, day to day conduct of its business in the same manner as theretofore. They will also usually agree not to permit the Target Company to do anything unusual or extraordinary (e.g., enter into any unusual transactions or agreements, not to dispose of any of its assets except in the ordinary course of its business, etc.).

Indemnity

The seller will normally agree to indemnify the buyer for breaches of the seller’ obligations, covenants, representations and warranties contained in the stock purchase agreement. This is an important provision from the buyer's standpoint.

Separate Agreements Part of the Acquisition Agreement Package

It is not at all uncommon that in addition to the stock purchase agreement, other contracts are negotiated and executed as part and parcel of the acquisition. The possible types of "other contracts" are too numerous to mention.

We mention one type by way of example. Frequently, the buyer wants certain key people connected with the Target Company to continue to work, whether as employees or consultants of the Target Company (or even of the buyer company). In fact, the buyer may be unwilling to go through with the acquisition unless those key people sign contracts to continue as employees or consultants. In that situation, the buyer will have to negotiate and conclude written contracts with those persons. They will be an integral part of the acquisition contract package.
NON-COMPETE AGREEMENTS OF THE SELLING SHAREHOLDER(S)

Usually, the buyer will not want the selling shareholder(s) to engage in competition with the Target Company, whether for their own account or for a third party. A non-competition clause is then needed. It may be in the main acquisition agreement or in a separate contract. If one or more of the selling shareholders will render services to the Target Company or the buyer company after the acquisition (see preceding section), such the non-compete clause would probably be inserted in the separate employment or consultancy contract of that person.

AGREEMENT WITH FINDER

If a so-called finder is engaged to locate a suitable Target Company, it is essential that a detailed finder's agreement be draft and signed before that party begins work. At a minimum, the finder's agreement should cover the following points:

- whether the finder will have "exclusivity" and if yes, what that means;
- how to handle information or leads about prospective Target Companies which the other party (buyer or seller, which-ever engages the finder) already has;
- the finder's commission or compensation;
- when the finder earns it;
- whether the finder may mention his client's name; and
- whether the finder has any obligations to assist, or right to participate in, the negotiations.

SOME DIFFICULT POINTS TO NEGOTIATE

Listed below are just a few examples of points that may be either difficult to negotiate or may otherwise present problems in connection with a stock acquisition of a private company (though some may well also apply to other types of acquisitions).

**Environmental Concerns:** Where the Target Company or any of its predecessors occupying the same facility are or were engaged in activities involving industrial waste, pollution or the like, the buyer will usually want the seller to agree to bear all or some of the risk of post-closing clean-up and/or capital expenditure arising from pre-closing conditions. This can be a difficult negotiating and contract drafting point.

**Product Liability Concerns:** Where the Target Company has been, prior to the closing, selling products involving a risk of product liability claims, it will be important for the buyer to be protected in the acquisition agreement against such claims. This can be a "sticking point".

**Existing Agreements with Target Company:** Sometimes, there will exist contracts between the seller and the Target Company by which one renders services to the other, or one grants certain rights and/or licenses to the other. Whether these should remain in force, and for how long, etc., can be difficult points to negotiate.

**Intercompany Loans and Debts:** When the Target Company owes money to the seller(s), the conditions under which the debt is to be paid off can be a difficult point to work out.

**Representations and Warranties:** A seller often wants to restrict and, in effect, dilute the representations and warranties it gives to the buyer, and their duration (time of survival after closing). Sometimes, the seller will not give certain of the important representations and
warranties the buyer wants and deserves. Or the seller may insist on limiting them to "the
knowledge of the Target Company's top management", rather than giving absolute, unqualified
representations and warranties. Here again, potentially these can be thorny points to iron out.

**Employment and Consultancy Contracts:** Often, one or more of the selling shareholders
will be individuals whom the buyer wishes the Target Company (or the buyer company itself) to
employ for a period of time after the acquisition. Negotiating and preparing the contract(s) can
prove difficult.

**Lending Institutions:** If the Target Company owes money to a financial institution, there
may be restrictions on the sale of the Target Company's shares (or the transfer of its assets) in the
loan documentation. Also, the buyer may have to negotiate new credit lines with the Target
Company's bank or other financial institutions to replace or supplement those in existence; and
substitute itself as guarantor in place of the seller(s). Very often, the contract documents of the
lending institutions are long and complicated, and the process of negotiating and completing
those new contracts are difficult and time consuming.

**ACQUIRING A PART OWNERSHIP IN A U.S. ENTERPRISE**

When acquiring a part ownership of an existing U.S. enterprise that will continue in
operation, a great many of the points made above will apply, particularly if the percentage
acquired and/or the acquisition price are significant. If what will be acquired is only a very small
percentage at a modest price, then, from a practical standpoint, some of the above points may not
be applicable, but others no doubt will.

In the part ownership acquisition scenario, what will result from the transaction is a joint
venture U.S. entity----an entity owned by two or more shareholders or owners. Thus, an
agreement similar to the type one would conclude if one were creating a new U.S. joint venture
company with two or more owners will be required, to deal with how the jointly owned business
is operated, the relationships between the owners, what they can and cannot do without prior
approval of the shareholders or owners or board of directors, restrictions on transfer of shares,
first refusal and/or option or buyout rights, deadlock situations etc. etc. Other contracts may be
necessary in this sort of situation, See, in this regard, Part VIII, “Joint Ventures in the USA”.

**CONCLUDING REMARKS**

Whenever possible, the buyer's U.S. counsel should prepare the first draft of the acquisition
and other agreement. If you or your company, as buyer, allows the seller(s) to prepare them, then
in all likelihood they will not come anywhere close to satisfying your needs and protecting you
adequately. It is usually much more difficult to rework the other side's contract draft than to
prepare the first one. In effect, if the seller prepare the first draft, you, the buyer, may have to
have your U.S. counsel prepare an entire new draft. That will often complicate matters, make it
difficult to work out a deal quickly, and may be more expensive. In short, to repeat, the buyer
should seize the initiative and prepare the first contract draft.

On various occasions, I have been told by my foreign client: "We have negotiated and agree
on all major points. The signing of the acquisition contract and closing will certainly take place
within two weeks from today." I then explain to my client that that is not how it is done in the
States. It takes time to prepare and negotiate the agreements, for the "due diligence" etc. etc.
There is a common English expression: "Buying a pig in a poke" It means buying something without doing a prior thorough job of studying and examining what one is buying and under what terms and conditions. You, the buyer, will not be happy if you buy a pig in a poke. In short, then, do not underestimate how long it will take to complete an acquisition. U.S. counsel experienced in such deals will be able to advise you of a reasonable timetable within which the deal probably can be consummated. However, even experienced U.S. counsel cannot always foresee what may arise.
PART X

RAISING FUNDS FOR A U.S. DIRECT INVESTMENT:
INDIAN BANKS AND OTHER SOURCES

• General

The Export-Import Bank of India (“Exim Bank”) facilitates promotion of Indian investment in the US by providing partial financing to Indians of their equity contribution in US joint ventures (“JV”) and wholly owned US subsidiaries (“WOS”). This is done under its Overseas Investment Finance Scheme. The Exim Bank financing can be by way of capitalization of exports in the form of plant and machinery, technical know-how or capitalization of earnings such as royalties, management fees, etc.; or equity (capital) contribution by way of cash remittances, as approved by the Government/ the Reserve Bank of India (“RBI”). Exim Bank also extends guarantees on behalf of Indian companies for raising finance overseas by their foreign (e.g., US) JV/WOS if such facility has been approved by the Indian Government/the RBI. Such guarantees are generally extended together with equity financing.

• Eligibility

If you make an equity investment in an existing or a new venture in the US, including an acquisition of a US company, with the requisite approval for such investment from the Government of India/the RBI (and, to the extent required, also from the US Government and other concerned authorities in the US), you would become eligible for Exim Bank financing.

• Lending Norms

The Exim Bank provides rupee term loans for financing equity contribution in any of the approved forms subject to the following norms:

(i) A term loan may not exceed 80% of the Indian investor’s equity contribution in its US JV/WOS.

(ii) The Indian investor company should have a good domestic track record, preferably with export experience and a sound financial position, and should demonstrate continued future viability of operations as evidenced by financial projections.

(iii) The soundness of the US venture must demonstrated. That includes a proper rationale for the project; synergy with its existing Indian operations; potential for foreign exchange earnings by way of technical and management fees, dividends, royalties, export of plant, machinery and goods; and the capability of the Indian investor to manage the venture successfully.
(iv) The Indian investor must obtain the necessary regulatory and statutory approvals, including any required permission for the investment under the Companies Act, 1956 (as applicable).

- **Period of Repayment**

  The repayment period and the installments payable semi-annually will be determined on the basis of Indian investor’s cash flow projections, including earnings from know-how, service and management fees, royalties and dividends to be derived from the US JV/WOS. The repayment period will generally be around five years, including moratorium.

- **Security**

  Exim Bank’s equity financing will normally be secured by the following:

  (i) A pledge of borrower’s shares or ownership interests in the US JV/WOS for which finance is made available, together with a mandate in favour of Exim Bank assigning all receivables from the US JV/WOS.

  (ii) An appropriate charge on the borrower’s assets in India or any other security acceptable to Exim Bank.

  (iii) An US investment insurance policy covering political risks to be obtained by the borrower and assigned in favour of Exim Bank.

- **Participation by Commercial Banks**

  Commercial banks may participate in Exim Bank’s Overseas Investment Finance Scheme. Commercial Banks may also opt to take a risk participation in term loans extended by Exim Bank subject to the guidelines/instructions issued from time to time by the RBI.

- **Refinancing of Term Loans Made by Banks to Indian Investors**

  Exim Bank provides 100% refinance to commercial banks in respect of rupee term loans extended by them to the Indian promoter company for equity contribution in overseas JV/WOS. As per prevailing RBI guidelines, commercial banks can consider loan for equity investment only under Exim Bank's Refinance scheme.

  Eligibility conditions are essentially the same as for direct Exim Bank financing. The amount of refinance will be decided on the basis of specific requirement and eligibility of the lending commercial banks and availability of Exim Bank funds under its refinance portfolio. Exim Bank will provide refinance at rate of interest determined at the time of its approval. A service fee of 1% of the loan amount is payable upfront. Commercial banks are free to charge interest to the ultimate borrowers at their discretion. The refinance loan is repayable to Exim Bank pursuant the agreed repayment schedule, without regard to the investor-borrower’s term loan repayment to the commercial bank.
• **Procedure for Application**

Application forms are available from Exim Bank offices in India. The application form should be accompanied by a detailed project report. Necessary Government/RBI approvals and other documents mentioned in the application form should also be submitted.

• **AN INVESTMENT IN A US JV/WOS MAY BE FUNDED OUT OF ONE OR MORE OF THE FOLLOWING SOURCES:-**

  1. It may be funded out of:-

     a) The balance held in the Exchange Earners’ Foreign Currency (“EEFC”) account of the Indian party;

     b) Foreign currency, including capitalization of exports, obtained via an Authorized Dealer in India in an amount not exceeding 100 percent of the Indian party’s net worth as of the date of the its last audited balance sheet;

     c) Utilisation of foreign currency proceeds raised through ADR/GDR issues.

  2. Swaps of shares, subject to the valuation of the shares of the company by a Category I Merchant Bank registered with SEBI or an Investment Banker/Merchant Banker outside India registered with the appropriate US regulatory authority, and subject also to the transaction having been approved by the Indian FIPB.


• **INVESTMENT OUT OF FUNDS RAISED THROUGH ADR/GDR ISSUES**

Qualifying Indian companies are allowed to raise equity capital overseas through the issue of ADRs, GDRs and/or FCCBs. To qualify, the company must have a track record of good performance (financial and otherwise) for a minimum of three years. Where an issue of ADRs, GDRs or FCCBs by a company is likely to increase the permissible investment limits of Foreign Direct Investment in India (“FDI”) under the automatic route, or where such an investment is made in the form of a project that requires government approval, the company must seek approval from India’s FIPB.

An Indian company desirous of raising foreign funds by issuing ordinary shares for equity issues through GDR or FCCB must obtain the necessary approval from the Government’s Ministry of Finance, Department of Economic Affairs.

An Indian party can lawfully make a US direct investment without any monetary limit out of funds raised through ADRs/GDRs if:
a) The ADR/GDR issue was made in accordance with the Scheme for Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme 1993 and the guidelines issued thereunder by the Indian Central Government.

b) The Indian party files with the RBI within 30 days of such investment, on form ODA, full details of the investment made.

A potential issuer company seeking approval to raising foreign funds should have a consistent track record of good performance, financial and otherwise, before being allowed to issue GDRs or FCCBs. Considering the importance of infrastructure projects and the need to encourage equity financing of such projects, the 3 years track record requirement can be relaxed for companies seeking GDR or FCCB issues to finance investments in infrastructure industries, such as power generation, telecommunication, petroleum exploration and refining, ports, airports and roads.

**INVESTMENT IN FOREIGN SECURITIES OTHER THAN BY WAY OF DIRECT INVESTMENT**

With a view to liberalising capital accounting transactions, the RBI has permitted an Indian company or a body corporate, created by an Act of Parliament, to issue FCCBs not exceeding US$ 50 million in any one financial year to a person residing outside India under the automatic route, without the Government or RBI approval. This is subject to certain conditions. The FCCBs to be issued must conform to the Government of India’s Foreign Direct Investment Policy (including Sectoral Cap and Sector where FDI is permissible) and the RBI’s regulations/directions. FCCB issues are subject to a ceiling of US $ 50 million in any one financial year.

**ACQUISITION OF US SECURITIES BY RESIDENT INDIVIDUAL UNDER ESOP SCHEME**

The RBI has given general permission to a resident individual in India who is an employee or a director of an Indian office or branch of a US company or of a subsidiary in India of a US company or of an Indian company to purchase equity shares offered by the US company under an Employee Stock Option (ESOP) scheme provided:

1. The remittances for the acquisition of foreign securities under the ESOP scheme are as per the terms of offer without any monetary limit.

2. The US equity holding in the Indian company is not less than 51 percent.

3. The shares so acquired can be sold without the prior permission of Reserve Bank so long as the proceeds are repatriated to India.

**Note that resident individuals who are either employees or director of an Indian office or branch of a foreign company in which foreign holding is not less than 51% are permitted to acquire foreign securities under the ESOP Scheme without any**
monetary limit. They are also permitted to freely sell the shares provided the proceeds thereof or repatriated to India.

In addition, the RBI grants general permission to a person resident in India –

a) to acquire US securities as a gift from any person resident outside India; and

b) to acquire shares under the Cashless Employees Option Scheme issued by a company outside India provided it does not involve any remittance from India.

**General Permission to acquire Qualification Shares**

(1) The RBI has given general permission to an Indian resident individual to acquire US securities as qualification shares issued by a US company for holding the post of a director in the US company:

Provided that,

(i) the number of shares to be acquired must be the minimum required for holding the post and in any case cannot exceed 1% of the paid-up capital of the US company, and

(ii) the consideration for acquisition of such shares cannot exceed US $ 20,000 in a calendar year.

(2) An Indian resident individual seeking to acquire qualification shares in a company outside India (e.g., a US company) beyond the limits of above provisos must obtain the prior approval of the RBI.

**Acquisition of US Securities by certain Category of Persons**

The RBI has granted general permission for acquisition of US securities in the following cases –

a) Purchase of shares of a US JV/WOS by employees/directors of an Indian investor (shareholder) company engaged in the field of software provided:

(i) the consideration for purchase does not exceed US 10,000 or its equivalent per employee in a block of five calendar years,

(ii) the shares so acquired do not exceed 5% of the paid-up capital of the Joint Venture or Wholly Owned Subsidiary outside India (e.g., US JV or WOS in the US), and

(iii) after allotment of such shares, the percentage of shares held by the Indian company, together with shares allotted to its employees, is not less than
the percentage of shares held by that Indian investor company prior to such allotment.

b) the purchase of US securities under ADR/GDR-linked stock option schemes by resident employees of Indian software companies including working directors, provided the purchase consideration does not exceed US $ 50,000 or its equivalent in a block of five calendar years.
PART XI

TAXATION OF FOREIGN INCOME OF INDIAN RESIDENTS;
CONCESSIONS AND EXEMPTIONS

• Tax liability of a Resident on his Foreign Income

You, the Indian party, should note as a starting point: the total world income of a person resident in India, under the Income Tax Act, 1961 (“IT Act”), is subject to Indian income tax.

An Indian resident’s foreign income, i.e., income accruing or arising outside India in any financial year, is subject to Indian income tax in that year even if it is not received or brought into India. There is no escape from liability for Indian income tax even if the actual remittance of income is blocked or prohibited by the foreign country. However, in the case of income arising in USA the remittance to Indian of which is blocked or prohibited, proceedings cannot be taken against the taxpayer for recovery of the Indian income tax assessed and due on such foreign income until the prohibition or blockage is removed.

Income that has once been included in the total income of an Indian resident on the basis that it has accrued or arisen to him outside India, cannot be included a second time based on it having been received or deemed to be received in India.

• Tax reliefs on the Foreign (e.g., US) Income of Indian Residents/ Resident Companies

The IT Act provides a number of reliefs, or by way of deduction from the total gross income, in respect of the foreign income of Indian residents. Income from a business or profession is computed in accordance with the provisions of sections 28 to 44D of the IT Act. The expression “business or profession” includes any trade, commerce, manufacture or vocation. The deductions available in the IT Act on the foreign income chargeable to tax under the head “profits and gains of business or profession” as relevant to overseas investment, directly or indirectly, are indicated in the following paragraphs.

• Deduction in respect of Profits and Gains from Projects outside India under Section 80 HHB of the IT Act

Note: This deduction will no longer be available from the assessment year 2005-2006.

Where an Indian company, or a non-corporate person resident in India, derives any profits and gains from the business of executing all or part of a foreign project under a contract entered into by it or him with the Government of a foreign state or any statutory or other public authority or agency in a foreign state or with a foreign enterprise, it or he is entitled to a deduction, in the computation of the taxable income, of 50% of such profits and gains. Subject to certain conditions, this concession is also available where the
taxpayer performs any work in connection with any foreign project undertaken by any other person.

The requirements of the section are that (i) the taxpayer is an Indian company or any other non-corporate person resident in India, (ii) the consideration for executing the project or the work is payable in convertible foreign exchange.

The benefit of this concession is available only in respect of projects for the construction of any building, road, dam, project or other structure outside India, the assembling or installation of any machinery or plant outside India and the execution of such other work outside India of whatever nature as may be prescribed by the Central Board of Direct Taxes (CBDT).

The aforesaid deduction is admissible only if the following condition are satisfied:

(i) The consideration for the execution of the foreign project or work is payable in convertible foreign exchange.

(ii) The taxpayer must maintain separate accounts of the profits and gains derived from the execution of the project or work forming part of the project.

(iii) The taxpayer must debit to its profit and loss account of the accounting year in which the deduction under this provision is to be allowed and credit to a ‘Foreign Projects Reserve Account’, a sum equal to 50% of the profits and gains from such project or work. The taxpayer must use the reserve during a period of five immediately succeeding assessment years for the purpose of the business and not for dividend or profit distributions. If, within five years from the end of the relevant accounting period, the taxpayer utilizes any of this reserve for a dividend or profit distribution or for any other non-business purpose, the deduction accorded under this provision will be deemed to have been wrongly allowed. Rectification of the relevant assessment to withdraw the tax benefit granted can be made by the Assessing Officer within four years from the end of the accounting year in which the “Foreign Projects Reserve Account” is utilized by the taxpayer for any prohibited purpose.

(iv) The taxpayer must remit to India in convertible foreign exchange 50% of such profits and gains within six months from the end of the relevant accounting year or by such later date as the Chief Commissioner/Commissioner of Income-tax may allow on being satisfied that the taxpayer was prevented from complying for reasons beyond its/his control.

If the amount credited by the taxpayer to the Foreign Projects Reserve Account or the amount so repatriated to India by it/him is less than 50% of such profits and gains, the deduction under this provision is restricted to the lesser of the amount actually credited to the Foreign Projects Reserve Account or the amount actually brought into India.
Double Taxation Relief

The foreign income of Indian residents, i.e., the income accruing or arising outside India, generally becomes subject to tax in India as well as in the country in which the income accrues or arises. The double taxation of such income is avoided by means of double taxation avoidance treaties entered into by the Government of India with the Governments of other countries under the IT Act. The relief under such treaties is granted either under exemption method or credit method.

Under the first method, the income that, according to the relevant source rule, arises in one country, is not taxed in the other country, though it can be taken into account for the purpose of determining the rates of tax.

Under the second method, although the income is taxed in both the countries as per their respective tax laws read with the relevant bilateral double taxation avoidance treaty, the country of the taxpayer’s residence allows him a credit for the tax paid thereon the country of source against the tax charged on such income in the country of residence. Credit is also given for the tax that would have been paid but for certain tax incentives, if the bilateral tax treaty so provides. In India’s double taxable avoidance treaties, relief is generally provided by a combination of both these methods. The Government of India has entered into comprehensive treaties for avoidance of double taxation with a number of countries.

See below regarding the Indian-US Double Tax Avoidance Treaty.

Unilateral Relief from Double Taxation

The IT Act contains provisions for the grant of unilateral relief in the case of Indian resident taxpayers on income which has been taxed both in India and in the country with which there is no agreement for the avoidance of double taxation. For this section to apply, the foreign tax must be levied in a country with which India has no treaty or agreement for relief against or avoidance of double taxation. It is immaterial that the tax paid in such a foreign country is in respect of income arising in another foreign country with which India has such a treaty or agreement.

The Indian–US Double Tax Avoidance Treaty

Such a treaty exists. A discussion of its provisions is beyond the intended scope of this Guide. The reader should note its importance as a tool in connection with any actual or contemplated US operation. That includes direct investments, exports to the USA, and many other transactions and situations. Competent tax advice and tax planning is important element in the overall equation.
PART XII

U.S. BUSINESS RELATED VISAS FOR INDIAN NATIONALS

- **Your U.S. Visa Requirements Should Be Part of the Planning Process in Structuring Your U.S. Operation.** U.S. visas needed by your key employees to be paid by your U.S. operation can affect the structure of the U.S. operation you are planning or already have in place (e.g., its ownership structure and capital). A **non-U.S. national cannot be paid from a U.S. source for services rendered unless he/she has a U.S. visa so permitting.**

- **Temporary U.S. Visas; Permanent Residence Visa (“Green Card”):** There are several different types of “temporary” visas available to Indian nationals meeting the corresponding requirements, among them (examples only):
  - B-1 Visitors Visa (and the somewhat similar B-2 Tourist Visa);
  - L-1 Intra-Company Transferee Visa;
  - H-1, H-2 or H-3 Visa;
  - E-1 Treaty Trader Visa;
  - E-2 Treaty Investor Visa;
  - O-1 and O-1(a) Visas for athletes and entertainers;
  - “A” Visa for diplomats.

  The permanent residence visa or “green card” is a permanent or “immigrant” visa, whereas the above listed ones are temporary.

- **The B-1.** With a B-1, a non-U.S. national cannot work for and be paid by any U.S. source. However, he/she can negotiate contracts, consult with business associates, litigate or arbitrate, participate in conventions and seminars, do research, and engage in certain other permitted activities in the States. With a B-1, each U.S. stay will be limited to a short period (6 months is the maximum but may not be granted for a particular stay)

- **L-1.** This visa is for a foreign (e.g., Indian national) “executive”, “manager” or “person of specialized knowledge” (all defined terms in the U.S. immigration law) who has worked for an enterprise outside the U.S.A. for at least 1 year within the past 3 years in one of those capacities and is being transferred to that enterprise’s U.S. subsidiary, branch office or affiliate temporarily in a comparable capacity. With an L-1, the holder can be paid for his/her services by the U.S. sub, branch or affiliate. Extensive documentation is usually required for L-1 applications.

- **The “H” Category Visas. 1. The H-1:** Among the requirements, the applicant must have professional level qualifications for a professional level position in the USA. Usually, this means that the position typically requires a baccalaureate (university) degree or an equivalent combination of education and experience. Applying for and receiving labor certification from the U.S. Department of Labor is also required for the H-1. That means convincing the Department, inter alia, that the U.S. employer will be paying the applicant a fair wage based on the going U.S. rate, that his/her employment will not displace other U.S. workers, and that there is no strike, lockout or work stoppage in that occupation. **The H-2:** Generally, the H-2 is for non-U.S. national workers or technicians needed to perform specific tasks in the States. One example might be to install and teach other workers of a U.S. company how to operate certain machinery. That U.S. company may pay the H-2 holder for his/her services.
As with the H-1, labor certification is required. **The H-3**: The H-3 is for an alien coming to the USA to receiving training from a U.S. employer. Stringent requirements must be met.

**Business Visa Types Not Presently Available to Indian Nationals**

The E-1 (Treaty Trade) and the E-2 (Treaty Investor) visa are not presently available to Indian nationals. The reason: India and the USA have not concluded the type of bilateral treaty that would open the way for these two important visa types. We only mention the E-1 and E-2 for general informational purposes.

- **E-1 (“Treaty Trader”)**. The E-1 is predicated on a qualifying company (from a treaty country) having a U.S. subsidiary, affiliate or branch (“US Operation”). The treaty country national seeking an E-1 must show that he/she will hold an executive or supervisory position in the US Operation and has the requisite skill for the post. At least 50% of the US Operation’s total volume of trade, which must be “substantial”, must be with the foreign treaty country. Nationals of the treaty country must own at least a majority of the treaty company. Generally, the US Operation will have to have been in actual operation for about a year. The E-1 holder can be paid for his/her services from the US Operation’s payroll.

- **E-2 (“Treaty Investor”).** The key for the E-2 is the amount of “capital” the treaty company or treaty national individual has invested in its US Operation. It must be sufficient for the type of business concerned (no precise amount is specified in the regulations). The applicant can be, but need not be, an owner of the treaty company, but he/she must be employed by it. He/she must be a manager or highly trained or specially qualified employee who is needed to develop and direct the US Operation.

- **“Green Card”**. The requirements for a “green card” will not be discussed here for lack of sufficient space (the source cited below discusses the “green card” in some detail). The following points are noteworthy: 1. A foreign (e.g., Indian) national may not be able to obtain a green card straight away. He/she may have to apply for and obtain, as a first step, one of the types of temporary visas described above. Later (but before the temporary visa expires), it may be possible to apply for and obtain a green card. 2. Once a person has a green card, that is not the end of the story: the holder must meet certain criteria (e.g., presence in the USA for minimum periods), failing which it can be revoked. 3. A green card holder becomes a permanent U.S. resident for American income tax purposes. That causes the holder to be taxable on his/her worldwide income.

*For more details on U.S. visas, see Chapter 10 of Aaron N. Wise’s “A Foreign Business Person’s Guide to American Law - Business Practices – Taxation”, available at no cost from him. See also the Appendix to this Guide.*
PART XIII

LITIGATION AND ARBITRATION IN THE USA

Americans inclined to start lawsuits or threaten to do so. Americans are, in general, inclined to start litigation or to threaten it - considerably more so than Indians. It is not just American lawyers that exhibit this tendency, but also (and particularly) American business people---in fact, Americas generally. The common expression 'sue the bastards' quite probably originated with an American business person, not a U.S. lawyer.

Americans often sue or threaten suit as a strategic device to obtain some sort of amicable settlement: a money payment, a new contract, an agreement by the other side to abandon its claims, or the like. The great majority of commercial litigations started are never decided by the court or arbitration panel. They are settled by the parties after the legal proceeding has begun. Sometimes, the threat of legal action is sufficient to bring about a settlement.

An example: a foreign firm sells goods to a U.S. buyer or grants a technology license to a U.S. party. The U.S. side does not pay for the goods or the royalties. The foreign firm sues the U.S. party in an American court. In such a case, the U.S. side=s lawyer will often respond by making strong counterclaims, possibly claiming high damages. Often such counterclaims are quite exaggerated and not at all justified. That is a strategy to frighten the foreign party into abandoning the lawsuit or concluding a settlement favorable to the U.S. side but not the foreign side. We would emphasize that in a U.S. litigation, the plaintiff or counterclaimant does not have to deposit any money with the court (e.g., in proportion to the damage amount claimed). Rather, in the USA, claims for very high amounts are commonly made in lawsuits, often for psychological reasons even though the party making them knows its chances of recovering them are small.

In our experience foreigners are particularly good targets for lawsuits and serious threats of litigation. They frequently do not understand the U.S. milieu, mentality and underestimate the chances and danger of a lawsuit. They often do not really fully appreciate the value in the U.S. climate of carefully drafted, American style contracts aimed at protecting them. They typically do not bring an American lawyer into the picture early enough to reduce significantly the risk of lawsuits and claims against the foreign party.

Litigation in US Courts: As a rule expensive and time consuming. Commercial lawsuits in the U.S. courts are typically expensive and time consuming. In most cases, it is not a swift method for resolving disputes.

Unless there is a contract between the disputing parties stating that you, the foreign party, are entitled to recover in litigation your legal fees connected with the litigation, U.S. law generally does not permit that. There are only a few exceptions to that rule.

The lawyers for both sides can use various procedures to delay the day of final decision of the case by the U.S. court. A good example is pre-trial discovery mechanisms. In a great many countries, it is primarily the judge who controls and directs the production of evidence. The lawyer presents his proof to the judge and from there, finds out what counterarguments his opponent has. In U.S. civil law suits, it is the lawyers for each party that obtain from the other,
normally without court intervention and well in advance of the actual trial, all of the evidence the other side. This is done via pre-trial discovery mechanisms such as:

! depositions (oral testimony under oath given by a witnesses, often in the office of the document inspection requests (the party receiving this request must provide opposing counsel with copies of all requested documents having some relevancy to the case. Locating, reviewing and assembling the documents can often be time consuming;

! interrogatories (written questions, which are often quite voluminous, complicated and take time to answer properly;

! notices to admit or deny (statements are made which the other party is asked to admit or deny).

This discovery can produce high legal fees for both sides, and, as mentioned, can be used as a delaying tactic. Of course, that does not always occur. Sometimes the lawyers will use no or relatively little pre-trial discovery. However, one should normally presume that in most cases there will be a fair amount of pre-trial discovery.

It is often difficult to initiate commercial lawsuits in the USA where the plaintiff is claiming less than around $100,000 in damages. The reason is that the costs, particularly legal fees, will normally be too high in comparison with the relatively small amount of damages. If, however, the parties have agreed to arbitrate their disputes and claims and the arbitration clause is properly drafted, then it might be cost effective to sue in arbitration for the small (or larger) claims.

General Suggestions. At the time of contracting with a U.S. party, you, the foreign party, should keep the following in mind:

! to the extent possible, stay out of the US courts;

! provide for arbitration of all claims and disputes in its contracts with U.S. parties (including in your General Terms of Sale), typically in the USA;

! be sure that contracts with U.S. parties are drafted, or at the least carefully reviewed, by US legal counsel with experience in the area.

Exceptions. There are situation in which serious consideration should be given to providing in a contract that a particular U.S. court will have jurisdiction for disputes and claims, or certain of them. One such situation might, for example be where the foreign party has licensed the U.S. side to use its trade secrets or confidential information. That might occur within the framework of a license agreement, a joint venture or a cooperation agreement. One of the main concerns of a licensor or JV partner is to be able to prevent the U.S. side from making authorized use or disclosure of the secret or confidential information. In such a situation, a U.S. court can react quickly by issuing first, a temporary restraining order and then, a preliminary injunction ordering the U.S. side not to take such action. While arbitrators might have the power to issue similar orders, often they will not be in the position to react quickly enough.

It is usually possible to state in the parties= contract that disputes and claims will be resolved by arbitration, but that one or both parties reserves the right to seek interlocutory relief (of the type mentioned above) from a court.
THE ARBITRATION CLAUSE; APPLICABLE LAW

General Considerations. Although arbitration has its pros and cons, it is usually the best solution for transactions with the USA and with U.S. parties. In the USA, the most well-known and used arbitral institution is the American Arbitration Association (AAA®) with its headquarters in New York City. It is capable of handling an arbitration anywhere within the USA and, additionally, anywhere in the world. The AAA's International Arbitration Rules and its Commercial Arbitration Rules are frequently used in commercial and international commercial disputes.

To repeat, a properly drafted arbitration clause will usually be the best solution for a foreign party. From the offensive viewpoint (claims of the foreign side against the U.S. party) a U.S. arbitration will normally be quicker and less costly than a lawsuit in a U.S. court. That also applies for smaller claim amounts. In a U.S. arbitration, the permissible scope of discovery (compared with pre-trial discovery in a U.S. court) is reduced. From a defensive standpoint (the U.S. side has claims/counterclaims against the foreign party), arbitrators are often inclined to award lesser amounts of monetary damages than a U.S. court, particularly if a jury is deciding.

Most U.S. parties will not agree to arbitrate disputes and claims in a foreign country or anywhere other than the USA; and will not agree to some "foreign" law or any law other than the law of some U.S. state being applicable to disputes and claims. They will as a rule agree to arbitrate disputes in some US city according to the AAA's International or Commercial Arbitration Rules. Moreover, clauses stipulating arbitration in a foreign country (not the USA) but stating that the law of some U.S. state will apply to the parties' relationship will usually not be good for the foreign party. It will usually be expensive, difficult and problematic to plead and prove American law before arbitrators outside of the USA. Although an arbitral award can normally be enforced in the USA through the New York Convention, experience has shown that the enforcement procedure is complicated and costly as compared to the enforcement in the USA of arbitral awards rendered within the USA. [Note: both the USA and India have adopted the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards].

The U.S. city in which the arbitration proceedings will occur, does not have to be the city where the U.S. side has its headquarters or a place of business. In fact, from the foreign party's standpoint, that should be avoided. Where possible, the arbitration clause should provide for arbitration in a U.S. city not too close to the American side's location (e.g., not where it has a place of business), and but one that is reasonable convenient for the foreign (e.g., Indian) side. Quite often, the parties in their contract stipulate New York City as the place of arbitration and provide for the application of New York State law to their contract (even though New York State may not have a material connection with the transactions).

Variations and special points regarding arbitration.

The parties may provide in their contract:

that if the foreign side (as supplier, licensor etc.) is the one initiating arbitration, it will be under the AAA's International Arbitration Rules in a particular, named U.S. city reasonably distant from the U.S. party's place of business; but if the U.S. side initiates arbitration, it must be take place in a named city in the foreign party’s country under, the
same AAA International Arbitration Rules or some other agreed arbitration rules. This variation permits the foreign party to attack in the USA where the American party is located—a distinct advantage; but allows it to defend in its home country—another important advantage. The U.S. party, of course, more often than not will not accept this formula, but it might well be worth a try.

that only the foreign (e.g., Indian) party has the right, at its sole election, either to arbitrate disputes and claims pursuant to the arbitration provisions in the contract, or to sue the U.S. side in a U.S. court. Under the laws of many U.S. states, such a provision is legally enforceable, at least for many types of agreements. It provides flexibility to the foreign party.

Obviously, there are many other possible variations too numerous to mention here.

Typically, U.S. parties will, in contract negotiations, initially refuse to have any court or arbitral tribunal other than one located very close to the U.S. side’s place of business decide disputes and claims, and will insist that the laws of that jurisdiction (U.S. State) apply to the contract and all disputes/claims. If, however, the foreign party is firm in negotiations, insisting on arbitration and applicable law clauses of the types noted above, it might end up with them.

Other important considerations regarding arbitration clauses

How many arbitrators should decide the disputes/claims, one or three? How should the arbitrators’ fees and other costs of arbitration be divided by the parties

Who should the arbitrator(s) be and how should they be chosen?

The following contractual provisions may, in a particular case, be beneficial of the Indian party:

a clause to the effect that claims based on the violation of the U.S. antitrust laws are not within the competence of the arbitrator(s) under the arbitration clause. The advantage is that the U.S. party, who would normally be the one making an antitrust law-based damage claim, would have to start a separate lawsuit against the Indian party in a US court. Often, such claims are not strong ones (and are raised primarily to frighten or “intimidate” the foreign party), so that the U.S. side might well be reluctant to spend the time and money to initiate a separate lawsuit.

a clause stating that each party can, despite the arbitration clause, apply to a court for interlocutory relief (e.g., a temporary restraining order and/or preliminary injunction).

a clause stating that the arbitrator(s) can, upon application of either party, require the other party to deposit security (e.g., a bond, bank guarantee) to satisfy any eventual monetary award in favor of the other party.

a clause stating that the prevailing party in the arbitration will be entitled to recover from the other party its own legal fees and costs connected with the matter.

a clause providing that if the U.S. side wishes to raise a product liability claim against the
foreign party, it must do so in the arbitration. For example, a person in the USA is injured or dies allegedly through the use of a product or component produced or sold by the foreign party, sues the foreign party=s U.S. distributor, agent, licensee or the like (the “U.S. contract partner”)-- but not the foreign party itself. The U.S. contract partner would like to bring the foreign party into the case, claiming indemnification of any damages awarded against it and its costs. If the arbitration clauses if properly drafted, it will usually be possible to avoid that---in other words, U.S. side would normally have to initiate arbitration under the arbitration clause to make its product liability claims against the foreign party.

**Last word on subject:** first class, U.S. style contracts are your best weapon and best protection. It cannot be emphasized enough that in connection with US transactions and business relationships, first class U.S. style contracts, prepared by competent U.S. legal counsel, are the best insurance policy for any company. That applies in particular for foreign companies. If the foreign party is an exporter, it should have first class General Terms of Sale prepared by an experienced lawyer, and use them correctly.
PART XIV

ERRORS FREQUENTLY MADE BY NON-U.S. PARTIES

Non-U.S. parties have often made and still make many errors in their U.S. business endeavors. Some are commercial, some legal, but the majority of them have both commercial and legal components. The reason is that commercial is legal and legal is commercial—-they are usually inextricably bound together. It is not possible in the space of this short booklet to list all the errors non-U.S. parties tend to make. Many have already been mentioned in previous Chapters. It seems appropriate to list a few truly notable ones here.

- **U.S. Product Approvals.** Some products cannot be brought into the USA and sold without the approval of a particular U.S. federal or state government agency. For some products, there is a registration process (and thereafter, possibly, periodic report filings) rather than prior approval applies. Be sure you check out if any such requirement applies to your product. Be sure also that the data you receive is current study. In one instance, a European company (“ECo) wanted to export into and sell in the USA non-prescription sunglasses. ECo received information from the commercial section of its country’s trade office, both in its home country and in the USA, that prior U.S. Food and Drug Administration (“FDA”) approval of the sunglasses was required, which could take months of effort to obtain. ECo engaged your author’s firm to review the situation. It turned out that the information ECo had received was no longer correct—the FDA had changed its policy and rules a few months before. No prior approval was required. Instead, ECo and its U.S. sales subsidiary only had to register with the FDA. That process involved completing several forms, mailing them in to the FDA, and receiving back registration numbers. Thereafter, annual reports would have to be filed with that agency. The registration process was completed in a couple of weeks. The hard part was locating and contacting the specific FDA offices dealing with the process (there are many FDA offices in several different locations). The point: If there is any reasonable doubt whether a prior U.S. government approval, registration or similar process may apply to your product, or what that process is, you should engage competent U.S. counsel to deal with those issues.

- **“Due Diligence” on Your Prospective U.S. Business Partner.** A fair number of non-U.S. business people meet someone at a trade fair or similar event, on the plane, through a friend, or in some other way. That someone says he/she (or his/her company) just loves the foreign party’s products or services and is ready to be its distributor, agent, licensee, partner etc. Without checking out very carefully, the foreign party agrees, either orally or in writing. That is a bad error. It could lead to business problems, legal problems or even a lawsuit. You need to investigate your potential business partners thoroughly (“due diligence”) before agreeing to or starting any business relationship. Your U.S. lawyer will usually be able to obtain valuable information about a prospective candidate. The point: Don’t get into bed with anyone without first carefully checking them out.

- **Letting Someone Other Your Most Trusted Employee Handle Intellectual Property Filings.** Some foreign companies permit their U.S. distributor, agent, joint venture partner, a friend, or someone other than one of the company’s most trusted employees handle the filing of the company’s intellectual property (patents, trademarks, copyrights, etc.). The result can
range from an error to an outright fraud. On occasion, the person entrusted will file the
application showing himself or his company as the owner-applicant, rather than the foreign
company. The point: These items are at the heart of your business. Only a very
trustworthy representative of your firm should handle these matters, working with
competent U.S. counsel.

- Intellectual Property Filings in the USA (or in the Western Hemisphere) a Priority
  Item. One of the very first things a foreign company should do——and many are remiss——is
to file applications in the USA and, where applicable, in other Western Hemisphere markets,
for patent, trademark, copyright and other intellectual property protection. You should have
these applications in process before you start doing business in those territories. Certainly
that is so for the trademarks, brand and trade names, slogans, logos and symbols that you
plan to use there. That process will involve first checking whether some third party has
already registered or applied for, or is using, that mark, name, etc. or one confusingly similar
here-to. You should not use and might be sued for using a mark, name, slogan, logo or symbol
that infringes a third party’s rights. Plus, if you have already started using such a mark, name
etc., and have to stop, you will incur expense and possible difficulty in getting potential
customers to recognize your new marks, brands, etc. The point: Putting your intellectual
property situation in order should be a priority item.

- Don’t Let Anyone But Your Trusted Employee Handle Setting Up Your U.S. Company,
  Working With Your U.S. Lawyer (and Other Experts). A true story will illustrate this
point. A European company (“ECo”) engaged what its owner (“ECo Owner”or “Owner”)
believed to be an old friend to work for the U.S. subsidiary corporation ECo intended to form
(“USCorp”). The “friend” told the ECo Owner that under the applicable U.S. law, at least
one shareholder of USCorp must be a U.S. permanent resident, which the friend was. In point
of fact, no shareholders have to be U.S. permanent residents—the statement was false. ECo
and its Owner intended that 1 share of USCorp’s stock be issued to ECo Owner, 1 share to
the “friend” as a nominee share to satisfy the supposed “legal requirement”, and the balance
of the 98 authorized shares to either ECo or a trust beneficially owned by ECo (whichever
ECo should decide later). ECo Owner believed he had conveyed that information to the
“friend” and that he understood and was in agreement. No written contract between ECo,
ECo Owner and the “friend” was ever prepared or signed. The “friend” proceeded to
form USCorp using a U.S. lawyer of his choice. They purported to issue 20 shares of its
stock: 10 to the “friend” and 10 to ECo Owner. The “friend”, from then on, claimed that he
was the 50% owner of USCorp. The “friend” also claimed that he was the President and CEO
of USCorp and, along with ECo Owner, one of its two Board of Directors’ members. The
substantial moneys (capital) invested in USCorp came from ECo. USCorp meanwhile signed
a lucrative, fairly long-term contract with a major U.S. customer to purchase ECo’s products
from USCorp. ECo and its Owner tried to settle the matter amicably with “friend”, but to no
avail. An expensive lawsuit in the USA and associated “pain” was the result for ECo and its
Owner. The lessons: 1. Be sure you control the entire process of forming the U.S. entity;
and 2. Make sure your agreements and “ground rules” are in writing, prepared by your
U.S. counsel.

- Using Service Companies To Form Your Own U.S. Company. Ads circulate in many
countries offering to form a U.S. company for a very low price. You should not hire any such
company. In your author’s experience, these service companies do not do the complete job
required to form and (in U.S. lawyer’s parlance) “organize” the company. That is
particularly so when the company is a “corporation” formed under the laws of a particular U.S. state. Services companies typically do not attend to matters like the documentation to elect directors and officers, adopt bylaws, set forth and approve capital contributions, issue the shares, and certain other measures. With certain variations, the same general principle applies to using service companies to form other types of U.S. legal entities, like limited liability companies (“LLCs”). The result is too often a defective or incomplete organization of the entity. Attorney-author Wise has been engaged many times to complete and bring up to date the organizational and other documentation of U.S. corporations that clients have formed using “service companies”. Generally, it will be more costly and complicated to fix up the deficiencies and defects after the fact than if the job had been done thoroughly and correctly in the first instance.

Some “service companies” claim in the ads that if you form a U.S. corporation or LLC under the laws of a particular U.S. state, like Delaware, and the entity’s income is generated outside of the USA, it will not be subject to U.S. taxation on its income. That is false. A U.S. corporation or LLC is subject to U.S. federal income tax worldwide, except that the LLC operates as a “pass through” entity----its owners are the ones responsible for paying the taxes (both the LLC and the owners must file US federal income tax returns).

• **First Class Contracts for the U.S. Market Are a Must.** If you want to optimize your chances of getting paid, succeeding commercially, protecting your intellectual property, and staying out of legal, tax and other trouble, you will need well-drafted contracts for the U.S. market prepared by competent U.S. experts. A literally limitless number of cases can be cited where foreign parties have not adopted that course, and have paid the price later. Here is one example. A European company (“ECo”), without using any lawyer (let alone a qualified American one) signed a “cooperation agreement” with a U.S. manufacturer-seller of similar industrial equipment. The agreement contained a clause prohibiting ECo from selling its own or similar products anywhere in North America for 5 years after the agreement ended. The agreement ended with the U.S. party owing money to ECo. Per the agreement, all disputes were to be resolved by 3 arbitrators in the U.S. party’s “home town” (in Indiana), and under Indiana law. The U.S. party started arbitration claiming ECo owed it money, and more importantly, to enforce the non-compete clause. The result was a lengthy and expensive arbitration with the U.S. side having the “home court” advantage. The point: Had ECo engaged competent U.S. counsel to draft and help negotiate the agreement, this misfortune would, in all likelihood, never have occurred.

• **Using Properly Drafted General Terms of Sale (“GTS”) Tailored to the U.S. Market.** They offer very clear and important advantages to foreign exporters, including for their U.S. subsidiaries and affiliates. The benefits are too numerous to mention here. Further References: A list of the benefits of properly drafted GTS tailored to the U.S. market can be found in Mr. Wise’s “A Foreign Business Person’s Guide to American Law - Business Practices - Taxation”, Chapter 14. Also on this subject is Mr. Wise’s guide “General Terms of Sale for Exports to the USA, the Western Hemisphere Generally and Worldwide: A Guide for the Foreign (Non-US) Exporter”. See this Guide’s Appendix.

• **Be Careful when Terminating U.S. Distributors, Franchisees, Sales Agents and Licensees.** Proceed carefully, with competent advice, before you attempt to terminate. Terminated distributors, franchisees, sales agents and licensees frequently sue based on alleged improper termination or raise improper termination counterclaims when suppliers,
franchisors, principals, or licensors sue them (e.g., to recover moneys due). The two lessons:
1. Make sure any steps you take to terminate (or not renew) are done properly; and 2. If the distributorship, franchise, agency or license agreement is properly drafted by experienced counsel, the risk of successful improper termination claims or that they will be made at all, will be substantially diminished. The second point means that issues relating to improper termination and the like must be checked before you, the Indian party, sign any agreement, and the contract must be properly drafted to reduce to the extent possible the risks of damage, indemnity or similar claims for improper termination by a U.S. distributor, sales agent, franchisee, licensee, or similar party.

- **Your U.S. Business Lawyer Should Be Part of Your Negotiating Team.** Experienced U.S. business lawyers absorb quickly the key features of your business and that of your potential contract partner, the respective mind sets, what you want to achieve in your deal, and other practical and commercial information. They will be able to guide and advise you regarding your contemplated business transaction. They are accustomed to negotiating a variety of business arrangements. Since, in the final analysis, they will be the ones preparing the contract documents, their participation in the negotiations will facilitate their task and typically result in the best work product.
APPENDIX

LIST OF OTHER FREE PUBLICATIONS RELATING TO THE USA AVAILABLE FROM THE AUTHORS

(Except as noted, the Author of these publications is the co-author of this Guide, Aaron N. Wise)


American Product Liability: “Good News for Business!” Recent Trends and Developments:


General Terms of Sale for Exports to the USA, the Western Hemisphere Generally, and Worldwide: A Guide for the Foreign (Non-US) Exporter


Purchase and Leasing of Real Property in the United States.
The author is David Berkey, Esq. Partner of Gallet Dreyer & Berkey, LLP, New York City, the same law firm as Mr. Wise.