

# **DOING BUSINESS IN THE USA**

## **A “BULLET POINT” GUIDE FOR FOREIGN BUSINESS PEOPLE**

**BY**

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## About the Author

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- real estate;
- technology transfer and licensing;
- industrial and intellectual property;
- computer law and contracts; internet law and contracts;
- tax law and tax planning;
- visas and immigration;
- litigation, mediation and arbitration (including product liability cases);
- trusts and estates, probate, wills (domestic and international);
- white collar criminal litigation;
- sports and entertainment law;
- other areas of U.S. and international law dealt with in this Guide.

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## INTRODUCTION

### THE PURPOSE AND ORGANIZATION OF THIS GUIDE

The overall purpose of this guide is to provide valuable information and tips to foreign business persons when they are contemplating, planning or actually engaged in

- business in the United States of America;
- how to deal with disputes with American parties, meaning, possible or actual litigation.

As a guide, it obviously cannot deal in great depth with the subjects, nor can it cover every area encompassed by this broad field. It does, nevertheless, cover many areas. It is written primarily for the non-lawyer--the business person. To the extent possible, the author has tried to make it readable for him or her, without overdoing the "legalese". The reader will hopefully obtain useful insights on the basics and some of the details on the subjects treated.

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**Caveat:** The present Guide and the other publications cited herein are 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 a substitute. While the writer has made efforts to be accurate in his factual statements contained in this Guide, neither he nor his law firm or anyone connected with it make any representation or warranty in this regard. Opinions, interpretations and predictions expressed herein are the writer's own.

## CHAPTER 1

### **EXPORTING AND SELLING TO THE USA; CONTRACTS WITH AMERICAN DISTRIBUTORS AND SALES AGENTS**

- **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. Also, stated very generally, there is US legislation relating to particular types of products, what they can and cannot contain, their labeling etc. Failure to comply can, in some instances, subject the manufacturer, seller and possibly others to fines and penalties. It can also be ammunition for product liability lawsuits for persons harmed by such infringing products.

Here are a few specific examples chosen randomly.

- The Consumer Product Safety Improvement Act, a federal law passed in the summer of 2009, makes it illegal for anyone to sell children's toys, books, clothes or jewelry and certain other goods if the items contain more than trace levels of lead or phthalates. Penalties are stiff, with violators facing potential prison terms and fines of up to US\$100,000 per violation. The Act applies not only to new items but existing stock as well.
- Recent federal legislation often called for short, the "Bioterrorism Act" applies to exporters of food and beverage products intended for humans and animals. It requires registration with the U.S. Food and Drug Administration, the appointment of a U.S. representative, certain document filing with regard to each shipment, and certain record retention by the exporter. The consequences for violations can be severe.

Certain products destined for the U.S. market can be tested and certified by a private industry organization (e.g., Underwriters Laboratories being one for particular types of products---there are others). Companies will typically want to obtain certification for their relevant products for several reasons, two being: difficulty in marketing them in the USA without it; and, to reduce to some degree the company's product liability exposure.

Certain services may require special licenses or permits, or may be subject to particular legal requirements.

- **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 search, before you start business, whether the use of the mark, name, slogan, etc. might infringe any existing, third party 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 search and application procedures for each type and the nature of the rights conferred are different.

- **Filing Your Copyrighted Works with the U.S. Copyright Office.** If you own items that are or may be protected by copyright, you need to protect them in the USA. That is done principally by **filing an application for registration with the U.S. Copyright Office. Doing that in a proper and timely way is really a must; failure to do that can result in serious problems for the copyright owner.** See Chapter 6, under the subheading “Intellectual Property in the USA” for more on this subject.
- **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 foreign 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 foreign 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 foreign 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. **More information about the “security interest” is available in the publications, “A Foreign. Business Person’s Guide to American Law...” and “General Terms of Sale....”**---see the list of the author’s other cost-free publications in the Annex.

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. You might also read the author’s guide “**Placing Your Goods ‘On Consignment’ with Your American Business Partner....**” ---see the list of the author’s other cost-free publications in the Annex.

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 Foreign 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 Chapter 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 foreign 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.

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 city in your home country (or possibly some third country) 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, for US income tax purposes, a "permanent establishment" in the USA or a "fixed base" in the USA from which you render services, if there is an income tax treaty between your country and the USA that utilizes these terms. Absent such a treaty, avoid acts

and actions that may cause you to be “doing business” in the States for U.S. federal, state or local income tax purposes.

- **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 Chapter 6 for a few comments on these subjects.
- **Internet Selling into the U.S. Market.** See Chapter 7.

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**For more details on the above subjects, see the author’s “*A Foreign Business Person’s Guide to American Law - Business Practices - Taxation*” available at no cost.**

## CHAPTER 2

### 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 foreign 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 (Mr. Wise) and many other knowledgeable American lawyers, these concerns are typically exaggerated, blown out of proportion, and do not reflect the realities. American product liability judgments awarding irrational, exorbitant damages ---including ones that seem to impose liability for no good reason---are very rare. These rarities are, however, fodder for the media.**

**You should be aware of the recent, major trend beginning several years before and extending through George W. Bush’s two terms in office, of reforming the American product liability legal regime. 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.**

**These developments are explained in the author’s publication, “*American Product Liability: ‘Good News for Business!’ Recent Trends and Developments---a Guide for Foreign Companies*”. Its Table of Contents is set out in this Chapter’s Annex.**

- **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 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 necessarily apply to all foreign parties in each and every instance. But they probably will apply to a considerable number. For more information about this very important point, you might consult the author’s guide “*American Product Liability: ‘Good News for Business!’....*” mentioned above.

- **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.
- **Non-U.S. Contract Documents Probably Won’t Do The Trick.** You should not assume that contract documents prepared according to foreign (non-US) 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 foreign company, will 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.

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## CHAPTER 3

### 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. Chapter 5 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.

- **Legal Form.** What legal form should most foreign business people select for their American business? The answer for most foreign 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 foreign parties; and there typically is no other form of legal entity that is appropriate--except the **“corporation”**.

A few more words are in order about the limited liability company = “LLC” and why it may not be the vehicle foreign parties should use. Tax-wise, the LLC is a pass-through. While the LLC itself must file a US federal income tax return (and possibly one or more state or even city returns), its owner(s) must obtain a tax number, have prepared and file these same tax returns and pay the resulting taxes due. A foreign (non-US) legal entity or individual should normally not have to do that---it should stay as far away from the US tax authorities and their worldwide auditing capabilities as possible. The use of a U.S. corporation will accomplish that. Also, it is typically more expensive to form and organize properly an LLC than a corporation. The corporation has well recognized internal structures, whereas the LLC does not. Preparing the LLC operating agreement properly along with related documents and features can often involve considerably more costs than the formation of a U.S. corporation. Third, while both a U.S. LLC and a U.S. corporation offer limited liability to its owner(s), there are situations where the LLC may potentially offer less limited liability than the corporation.

- **What’s Wrong With Just Setting Up a Branch Office of My Company?** For the overwhelming majority of foreign companies, a “branch” in the USA of your home country company (or any other non-US company in your group) is not the way to go. A branch of a foreign company is just an extension of that company within the USA. It subjects the company to (1) being a more visible target for lawsuits and claims in the States; and (2) being liable for U.S. federal, state and possible local income taxes, and possibly other taxes. That applies for an “unregistered” as well as a “registered branch”. An unregistered branch

means any U.S. place of business or the like of the foreign company which is not registered to do business in the U.S. state in which it is conducted its business. A “registered branch” is one that is formally registered to do business in that U.S. state. If, under the laws of a particular U.S. state, the foreign company’s business activities through its operations in that state is sufficient to require it to register there, it must do so or run the risk of penalties and other negative consequences. That does not mean just establishing a sales office in that state, rather, it can include as well having an employee there, having a stock of goods there, including on consignment, and other “links” with that state. Essentially, one could loosely say that any type of business activities within the USA involving some sort of presence of the foreign company, can be viewed as a possible “branch”.

The same is true if one or more individuals establish an unincorporated (in the USA) business operation in the States.

In many foreign countries, it is quite common, without inordinate risk, for a foreign company to establish a branch. Not in the USA. There are a few exceptions, but very few. For example, some banks in the USA operate as branches or representative offices.

But to repeat, for the great majority of companies, the best advice will be to form a U.S. legal entity offering limited liability to its owner(s). The entity of choice will typically be the “corporation”.

- **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 company 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 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, a foreign 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.

- **Can Your Use of a Corporate or Company Name Infringe a Third Party’s Trademark Rights?** Yes. That is one important reason why, before definitely selecting a corporate or company name and forming the US entity, your U.S. lawyer should research for you whether the key word(s) in it are protected in the USA by third party trademark rights, particularly if the third party’s business is somewhat similar to what yours will be. If the US entity will promote, market and sell in other countries like Canada and Mexico, similar research would make sense. If the research turns up some serious potential problem, then you should select a corporate or company name not involving that risk. If legally possible, you should also give serious consideration to applying for trademark protection for the key word(s) in the selected U.S. entity’s name in the relevant countries, the USA, Canada, Mexico etc.
- **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). However, if the foreign party should wish and qualifies to obtain an “E” type U.S. visa for one or more key nationals who will work for the U.S. corporation (particularly an E-2 Treaty Investor visa), the total amount of the corporation’s paid-in capital must be of a sufficiently high level for the type of business operation concerned. On this point, see Chapter 10.
- **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 (like “directors’ qualifying 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 sense of the term that term is used in many other countries. 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.
- **Office Leases; Other Premises Leases; Warehouse Leases; Foreign Trade Zones**
  1. **Office Leases.** You can lease office space in many different ways: a lease of real office space in a building; leasing space from a business incubator or "baby-sitting" firm; leasing via an office-sharing arrangement; leasing a "virtual office", etc. It is true that there are various types of pre-printed office leases, and most of those are pro-landlord. Moreover, landlords often either modify a pre-printed office lease to make it even more landlord friendly, or create their own. Moreover, if U.S. work visas (like, for example, an L-1 intercompany transferee or

E-2 or E-1, or H category visa) are needed for key employees of your U.S. entity, the type of office space lease you conclude will be important. U.S. immigration will want to see a genuine lease of office space (typically not a virtual one or home office of an employee) sufficient to house the number of employees you anticipate having, and for a term sufficient to match the number of years requested in the visa application(s). Thus, you are well advised to have your U.S. lawyer counsel you on the above, and review and negotiate the landlord's lease draft. For more information on this subject, you might consult the author's cost-free guide, *"Purchase and Leasing of Real Property in the United States"*.

2. **Other Premises Leases.** Certain businesses will require particular types of premises. These might include set up of a restaurant, school, academy, museum, hair salon, or other service business requiring a particular type of premises in terms of location, size, configuration etc. The corresponding leases will often be more complicated and difficult to negotiate to suit the investor's needs. The comments under "Office Leases" apply as well.

3. **Warehouse Leases.** You may need a warehouse for your goods. Many warehouses offer a variety of services to choose from, ranging from mere warehousing, to that plus invoicing customers, shipping, etc. Most of the points under "Office Leases" will apply to these.

4. **Foreign Trade Zones ("FTZ").** FTZs are secured areas legally outside of U.S. customs territory. Their purpose is to attract and promote international trade. They are operated as public utilities by states, political subdivisions or corporations chartered for such purposes. Any foreign or domestic merchandise not prohibited by law, whether or not subject to U.S. customs duty, can be placed in a FTZ. In general, merchandise in a FTZ can be stored, sold, exhibited, broken up, repacked, assembled, graded, cleaned, mixed with foreign or domestic merchandise, otherwise manipulated, or destroyed. No retail trade can be conducted there. Some of a FTZ's advantages are: (i) customs duties or, if applicable, federal excise tax, are paid only when merchandise is transferred from a FTZ to U.S. customs territory for consumption or use; (ii) goods can be exported out of the U.S.A. from a FTZ free of U.S. customs duty and tax; (iii) procedural requirements for using a FTZ are minimal; (iv) goods can remain indefinitely in a FTZ. There are other advantages as well.

- **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?"**

- **Government Investment Incentives.** At the federal level, there are none. U.S. states offer various investment incentives, as to many local government units. For the most part, no

significant investment incentives are available unless the investment will produce a fairly large number of jobs for American citizens or residents, or involve setting up in a particular area targeted for development. However, even if no significant incentives are available for your particular investment, the state and local economic development authorities will typically provide considerable useful information, contacts, facilities, and the like. A number of U.S. states have economic development offices outside of the USA, and contact with them can be beneficial, at least as a starting point.

- **Insurance; Payroll Company.** You will need certain types of insurance for the U.S. operations, and may wish to consider other types. Examples in the commercial insurance area are: general liability insurance; product liability insurance (which may or may not be part of the general liability insurance); business property insurance, covering your own goods and physical property; directors and officers liability; employer's practices liability; intellectual property infringement; professional liability (errors and omissions); and workers compensation insurance. In the personal insurance area, medical, disability and life insurance are examples. You will probably want to (and have to) contract all or most of these from an insurance broker located in the States. See Chapter 4 regarding personal insurance. Your U.S. lawyer will often be able to suggest a reputable one with which he/she works, and assist you in deciding on what insurances you need, obtaining quotations, and in putting them in place. The same applies for engaging a payroll company to handle the U.S. entity payroll and possibly other functions, if you decide to go that route. These, particularly insurance policies, take time to put into place, thus, an early start is generally needed.
- **Accountant.** You will need one. The accountant can perform a variety of services, like advice in tax planning (often, together with your U.S. lawyer), doing the bookkeeping, preparing financial statements, and preparing tax returns. Your U.S. lawyer will frequently be able to suggest reputable accountants he knows and works with, or that he can locate, of the size and type to fit your requirements. It is beneficial that your U.S. lawyer and accountant already have or establish a good working relationship. **Note: the majority owner(s) of the U.S. entity should select the accountant and other outside experts, not, for example, an employee of the U.S. entity that is not a majority owner. The majority owner(s) will want the accountant's/outside experts' loyalties run to them and not anyone else.**

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**For more details on the subjects of this Chapter, the author's cost-free publication, "A Foreign Business Person's Guide to American Law - Business Practices –Taxation, may be useful.**

## CHAPTER 4

### **DEALING WITH EMPLOYEES: OVERVIEW OF KEY 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 has been treated in other Chapters of this guide. By way of example, see Chapter 10 regarding U.S. visas for foreigners. We will not reiterate those points here.

In this Chapter 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 foreign 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.

The preceding remarks should be read together with the following points.

- **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 employer 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. That includes discrimination based on race, color, national origin, religion, age, gender, disability, marital and veteran status. 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 Retaliation against Employee(s) Wishing to Unionize.** Not only can employer retaliation of this sort violate state law, but it may well constitute an "unfair labor practice" under U.S. federal labor law.

- **Employee Claims and Lawsuits Among the Top Types.** Claims made and lawsuits (or arbitrations) brought by employees against their employers or former employers are among the the most prevalent types in the USA----maybe number one. Your U.S. lawyers should counsel you from the beginning and regularly as to the "dos" and "don'ts" and "cans" and "cannots" with regard to interviewing prospective employees, hiring practices, dealing with them while employed by your company, and upon their dismissal or departure, and sometimes, thereafter.

- **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; Workers Compensation Insurance.** 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. Often, the best choice is a payroll company.

Workers compensation insurance is mandatory. It insures the employer from its employee's claims for job related injury and illness. You can use your lawyer, accountant or insurance broker to contract it, or have your payroll company do it. However, your lawyer should be involved for several reasons, one being to be sure that the scope of workers compensation coverage is what you need.

- **Employee Pensions and Profit Sharing Plans; Certain Other Employee Benefits and**

**Incentives.** U.S. law does not require enterprises to offer pension plans, profit sharing plans, medical, disability or life insurance coverage to employees. Often, the employer will want to obtain and establish various one or more of such benefits, and/or others, for its employees. For newcomers to the US market, particularly smaller companies, this can be a difficult and time-consuming exercise. See the bullet point below.

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.

- **Getting Into Place the Employee Benefits Package and Commercial Insurance: Start Early.** Quite often, getting the employee benefits package like various insurances, pension or profit sharing plan, and other benefits, as well as contracting a payroll company and coordinating the payroll with the company's bank account, plus deciding on and obtaining the desired commercial insurance are not easy tasks and require time. Your author has found that working and coordinating with a good, efficient insurance brokerage firm is frequently the best solution. This process should normally start before a new U.S. enterprise is set up, as it takes times to decide on what the benefits package and commercial insurance should be (type, scope of coverage, etc.), to obtain quotations, evaluate the coverage and cost, and set them up.

- **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 perform 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. The risks of this occurring are reduced by proper planning and action from the start.

## CHAPTER 5

### 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 foreign 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.
- **Three Typical Types of U.S. JV:**
  1. Distribution JV: Foreign 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 foreign party'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 foreign party's 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: A foreign 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 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 foreign party, 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 Foreign Client.** The foreign partner 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: a foreign 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.

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**For more details on U.S. joint ventures, see Chapter 8 of the author's "*A Foreign Business Person's Guide to American Law - Business Practices - Taxation*", available free on request.**

## CHAPTER 6

### INTELLECTUAL PROPERTY, LICENSING, TECHNOLOGY TRANSFER AND FRANCHISING IN THE USA

#### INTRODUCTION

In this Chapter, we cover three separate areas: intellectual property in the USA; licensing and technology transfer to the USA; and franchising in the U.S. market. By licensing, we mean the licensing of patents, trademarks, copyrights, know-how, and even computer software licenses. We will not attempt to define “franchising” or what constitutes a “franchise”. The U.S. federal and state legislation on franchising and franchises contain definitions, and for our purposes, how they define “franchise” is what really counts.

#### INTELLECTUAL PROPERTY IN THE USA

- **Patents:** A U.S. patent confers an exclusive right upon its owner to use the patented **invention** and prevent anyone else from using it for the patent’s duration. The invention must be a new, novel and non-obvious product (manufactured article), process, machine, chemical composition or a distinct, new variety of plant. The patent’s term is generally 20 years from the U.S. application filing date or, in special cases, from the filing date of an earlier related U.S. application. A design patent, valid for 14 years, applies to a new, non-obvious ornamental design of a manufactured article, not its structural or functional features. A foreign (non-U.S.) patent does not protect the patented invention in the USA or in any country other than the one that granted it. Under U.S. law, a patentee that makes or sells patented articles, or its licensee, must mark the articles with the word “Patent” and the patent number. Not doing that precludes the patentee or its licensee from recovering damages from an infringer unless the infringer was duly notified of the infringement and continued to infringe after the notice.

Some types of computer software can qualify for U.S. patent protection, and where that applies, the protection will usually be stronger than by copyright. You may wish to explore that potential option.

- **Trademarks:** A U.S. federal trademark registration is an exclusive right of the owner to use a specific word or words, name, design or logo, or other designation of source of origin, or combination thereof, in connection with specified goods and/or services. It is valid for 10 years, and is renewable if certain requirements are met. Trademark rights can be used to prevent others from using a confusingly similar mark. Certain trademark rights may accrue to the holder of an “unregistered mark” used commercially in the USA (a “common law trademark”) but they are normally less extensive and more tenuous than those conferred by a U.S. federal trademark registration. A federal trademark applies throughout the USA. U.S. states have their own separate trademark system, thus, a trademark can, upon meeting the requirements, be registered in one or more particular states. It is possible for the owner to obtain both a U.S. federal and one or more state registrations for the same mark. A foreign registered trademark does not confer trademark protection upon its owner in the USA or in any other country than the one in which it is registered.

- **Domain names:** A **registered domain name** confers upon the registrant the exclusive right to use it for its website and on the Internet. It is not to be confused with a registered U.S. federal or state trademark. In fact, it is possible that use of your domain name may infringe the trademark rights of a third party; or, that a third party's domain name use can infringe your trademark rights. Also, often there are a number of domain names that are very similar or even identical, except for, e.g., its TLD (.com, .org, .biz, .edu, etc.), so that the scope of domain name exclusivity is narrowly circumscribed. There are great number of domain name registrars, which are accredited by The Internet Corporation for Assigned Names and Numbers ("ICANN" or "InterNIC"). It is possible to lose one's domain name to another holding a federally registered trademark or superior rights to the mark. Holding a federally registered U.S. trademark for the same name as your domain name is typically the best solution for you (the foreign company or business person).

- **Copyrights.** A **copyright** under U.S. law provides protection to an author of an original, copyrightable work of authorship, including literary, dramatic, musical, artistic, architectural, and a broad range of other works, both published and unpublished. The work must be fixed in a tangible medium of expression. It confers on the owner the exclusive right to reproduce the work, to prepare derivative works, to distribute copies or phonorecords of the work, to perform it and display it publicly. Copyright protects the work's form of expression rather than the subject matter. For example, an original description of a machine could be copyrighted, but that would only prevent others from copying that description; it would not preclude others from writing their own description or making or using the machine. Under U.S. law, a copyright's duration depends on, e.g., when the work was created, published and /or registered with the U.S. Copyright Office; and on whether it was created by an individual, more than one individual, or an employee or at the direction of another person or company; and if the work was created before or after January 1, 1978. Those rules are too complicated to explain here. While copyright arises upon creation of the original work (when it is fixed in a copy or a phonorecord for the first time), filing with the U.S. Copyright Office is necessary to properly protect the owner. Regarding that last point and others, see the section below, "**Filing with the U.S. Copyright Office (Copyright Applications)**".

- "**Trade secrets**" are well protected in the USA. A "trade secret" can be, broadly speaking, any type of information of an industrial, technical or commercial nature known to one or a limited number of enterprises or interested persons, which has some value to the holder and which the holder treats as being secret or proprietary. Examples of trade secrets include: a secret process, method, formula, device, manufacturing procedure, method of construction, or a customer list. If "know-how" (which has no precise, legal definition) is secret, it can be protected in the USA as a trade secret.

- "**Right of Publicity**" and "**Right of Privacy**". There are certain other "rights" that might be considered to fall with the general scope of intellectual property, for example, "**rights of publicity**" and "**rights of privacy**". Generally and loosely speaking, the former protects an individual's right against unauthorized use of his persona, personal image, personal characteristics etc.; and the latter, against unauthorized invasions of his or her right of privacy. These are matters of U.S. state law, and the extent to which one or the other or both are recognized, and the scope of protection, varies from state to state. Some states have specific statutes dealing with one or the other (e.g., New York State and California). In some states, a common law right, particularly of privacy, may also apply.

- **The Trademark Application Process in the USA. The process of getting a trademark registered in the USA can be complicated and time consuming.** First, your lawyer has to do a “trademark search” to determine whether there are existing, third party registrations, pending applications, common law marks etc. that might present a problem. That can be done in two ways: ordering from a search company and analyzing a formal search report; or by searching the US Patent & Trademark Office (“USPTO”) website. The former is the more comprehensive, safest way. Assume that the search reveals no significant problems, and that the decision is made to apply for trademark protection---to prepare and file an application.

The US and many foreign countries are parties to an international trademark Protocol (Madrid Protocol). If the foreign party’s country is a party to it and has a home country trademark registration for the mark it wishes to protect in the USA covering the same general types of goods and services it wishes to protect there, it can use that registration to generate an “international application” and file that in the USA. Generally speaking, that is not advisable, at least if the “international application” is not reviewed and “sanitized” by U.S. counsel before filing. The typical foreign country registration will set forth the goods and services in a very broad way, and the USPTO examiner will not accept that. The USPTO requires that the goods and services be very specifically described. Also, sometimes, goods and services that appear in a foreign registration under one or the other Class, will not correspond to the same Class in the USA. The result, often enough (and this author has experienced a number of cases of this type), is a tedious and expensive procedure to adapt the goods and services description to one that the USPTO examiner will accept. Additionally, it typically takes a longer time for an “international application” to reach the USPTO and an examiner than a traditional U.S. application. The point is: either have your U.S. lawyer prepare the U.S. trademark application (not using an “international application” at all); or, if the decision is to proceed with an “international application”, then have your U.S. lawyer review and adapt it before it is filed with the USPTO to one that the assigned USPTO examiner is more likely to find acceptable.

The reader should bear in mind that the USA is a “use country”: a U.S. trademark registration will not be granted unless and until the applicant states and presents evidence to the USPTO that it has used the mark commercially in U.S. interstate or international commerce, for at least one item shown in the particular trademark class concerned. The U.S. application will either be based on such “actual use” having been made, for the particular class or class concerned; or, for the classes in the application in which that use has not yet been made, based on “future intent to use”, and at a later point in the process, the applicant will have to file a declaration and evidence of the “actual use” to obtain a registration for that class. The “international application” mentioned above offers the advantage that one does not have to claim and demonstrate “actual use” at any point in order to obtain a U.S. registration. However, that “advantage” should not fool you into thinking that the “international application” is the way to proceed---your U.S. lawyer should evaluate that and help you decide.

In passing, the trademark application process in Canada, also a “use country”, is also rather complicated and quite similar though not identical to the U.S. model. But more complicated and tedious than that of most European countries. Two key differences: Canada does not use “trademark classes”(which can make for complications); and the “international application” discussed above

cannot be used in Canada as that country has not adopted the Madrid Protocol.

The trademark application process in Mexico is rather simple, similar to that in many European countries. Mexico is not a “use country” in the sense mentioned above for the USA and Canada. It has a “wrinkle” or two, such as that for each trademark class in which one applies, a separate application must be filed.

The main reason for mentioning Canada and Mexico is that commonly, a company will want to search and, if that goes well, apply for trademark protection in the USA and in both of those other countries, or at least in Canada.

**This author normally advises clients that the trademark work is among the very first things they should undertake. Likewise for the patent and copyright work.**

- **Filing with the U.S. Copyright Office (Copyright Applications).** While nearly universally copyright arises on creation of a copyrightable work, the USA is the only country known to this author that requires registration of the work with the U.S. Copyright Office to obtain the full scope of protection and legal remedies against infringers. Among other benefits, registration

- is necessary before a copyright infringement suit can be filed in a U.S. court for works of U.S. origin.

- if done within 3 months after publication of the work or before an infringement of the work, enables the copyright owner to claim “statutory damages” and an award of its attorney fees in court actions. Otherwise, only an award of actual damages and profits is available to the owner.

- allows the copyright owner to record that document with the U.S Customs Service to protect against the importation of infringing copies of the work.

See above regarding a general description of copyrightable items. More particularly, among the types of items that can typically be protected and filed include: (i) computer software; (ii) designs, specifications, and descriptions of a machine, product, or the like; (iii) publications and manuals; and (iv) your website text. A proper copyright notice should be put on your copyrighted items. As already mentioned, certain types of computer software may qualify for U.S. patent protection, and that should be explored since patent protection may offer greater benefits. **In short, if you have copyrightable items, you should have your U.S. lawyer file copyright applications for them with the U.S. Copyright Office. This too should be a priority item.**

## **LICENSING AND TECHNOLOGY TRANSFER TO AND WITHIN 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 and patent applications, trademarks (whether or not registered) and trademark applications, internet domain names, copyrights (including to 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 foreign 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 a 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. if 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 foreign 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 foreign 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 relevant income tax treaty should be consulted (if any). As a general rule, a foreign party should do everything possible to avoid having what U.S. tax treaties defines as a "permanent establishment" in the USA or a "fixed base" used for the rendering of services in the USA. Absent a relevant tax treaty, the foreign licensor should avoid acts that would cause it to be "doing business" in the USA (or a particular U.S. state or city), for income tax purposes. Other 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 Chapter and in Chapter 1 of this Guide apply, either directly or with some adaptation, to computer software licenses and authorized software reseller agreements. Chapters 7 (Internet Business: An Overview of U.S. Cyberlaw), 11 (Litigation and Arbitration in the USA) and 12 (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 one example, New Jersey’s franchise act brings 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. This author has dealt 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 prepared 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. **Non-US Style License, Reseller and Other Computer Software Agreements:** Foreign software agreements should not be used in the USA ----at least without adaptation. Many legal and some practical business points of substance contained in agreements of this type that are not prepared by U.S. counsel will not be suitable for the US market. That is the main point. Plus, when marketing software to US resellers or customers, the agreements should be in proper, US style English.

5. **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.

6. **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, maybe not even in its home country). 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 application or registration, but may be reluctant due to the costs.

7. **Copyright Protection for Computer Software and Manuals.** Filing timely copyright applications in the USA very important for software owners and licensees. See earlier in this Chapter under the major heading “INTELLECTUAL PROPERTY IN THE USA” for more detailed comments about that and related points.

## **FRANCHISING TO AND WITHIN THE USA**

This section assumes that you, the foreign party, wish to establish a franchise system in the USA. On this subject, there are multivolume books written. We can only provide a few comments by way of overview on this complex subject.

- **Franchising Heavily Regulated in the USA at the Federal and State Levels:** First, there are federal regulations on franchising and “franchises” to comply with (the so-called “FTC Rule” and interpretative guidelines). There are also federal statutes applicable to certain specific, narrowly defined franchises business types. At the state level, many of them have a general statute regulating franchising and “franchises”. Some also have laws concerning specific types of franchise businesses.

The franchisor will have to prepare, file in the appropriate offices and obtain approval of, and give to prospective franchisees in advance (within the time period established by law) a complex, detailed offering statement (a franchise offering circular or offering document) roughly similar in its overall general nature to an offering statement that a company going public in the USA would prepare, file and disseminate. The offering document must be amended and updated each year, and more frequently if there are any material changes, as long as the franchisor is continuing to offer franchises for sale. For purposes of the FTC Rule and many if not most state franchise statutes, one offering statement can be used (the Uniform Franchise Offering Circular). Frequently, it will be necessary to amend and supplement it to comply with the requirements of applicable U.S. state statutes. Copies of the franchisor’s standard franchise agreement and any related agreements (e.g., leases, supply agreements, specifications, purchase orders) form part of the offering circular and must be given to prospective franchisees at the same time as the basic disclosure document. All of these must comply with the FTC Rule and the pertinent state statute(s), as well as other American federal and state laws. Several of the state franchise laws contain stringent rules (for the franchisor) regarding what a franchise agreement cannot and/or must contain, franchise termination, renewal and non-renewal, modification of franchises and franchise agreements, and many other points; and provide franchisee-friendly legal remedies for violations committed by the franchisor.

Many other laws, federal and state, apply to and may affect franchise agreements and relationships. One such type are federal and state antitrust laws, affecting, for example, certain competitive restrictions that a franchisor might seek to impose on a franchisee.

Another issue among the many is whether an arbitration clause placed in a franchise agreement to resolve disputes and claims will be legally enforceable, as a whole or as to particular issues that may arise.

- **Ways of Structuring a U.S. Franchise Operation:**

Among the most common structures for a foreign party to approach the U.S. market by way of franchising are:

- Establish a wholly-owned U.S. subsidiary (e.g., a U.S. corporation), grant it the necessary rights for the USA, and regarding the franchise trademark(s) for the U.S. market, either grant it a license (e.g., an exclusive one) or have it be the owner of the U.S. mark(s). The U.S. subsidiary would grant the franchises as franchisor and contracting party, and possibly own and operate one or more company-owned franchise operation units.
- Set up a U.S. joint venture with one or more JV partners; grant it the necessary rights and licenses (or allow it to own, e.g., the U.S. trademark(s) concerned), and have the US JV sell franchises----and possibly, own and operate one or more company-owned franchise units or outlets. While the FTC Rule does provide an exception to its application for certain kinds of “partnerships” functioning as franchisees, most foreign companies will be unable (and even unwilling, considering what may be required) to structure the JV to avoid the JV itself being treated as a “franchisee” and the arrangement being treated as an offer by it to the JV to sell or distribute “franchises”. Thus, that JV arrangement itself is likely to require the foreign party, as franchisor, to comply with the federal and pertinent state legislation.
- Grant one sole exclusive license of the U.S. trademark(s) for the entire USA applicable to the franchise operations to an independent U.S. company, to use them and other intellectual property and rights of the foreign party (e.g., trade secrets and know-how, copyrights) to sell franchises in the U.S. market, pursuant to the foreign company’s franchise plan, format etc. or pursuant to specifications and other obligations that it establishes. That would be, in essence, a “master franchise agreement”, although that term might be avoided in the license agreement. Such an agreement, in a given case and if structured properly, might fall within a certain exception under the FTC Rule and possibly certain state franchise statutes, i.e. the exclusive license itself might not be an offering or a grant of a “franchise” thus exempting the foreign party from compliance with that legislation. A key aspect will be the extent of control the foreign party has over the U.S. licensee’s entire method of operating the business in question, and how significant those controls are. In any case, the exclusive licensee would have to comply in order for it to offer franchises to others, and quite probably, the franchise offering circular it prepares will have to contain certain information about the foreign party. If the abovementioned “one exclusive license” were not for the entire USA but only a part thereof, the chances of successfully falling under that FTC Rule exception are less.
- **Other Applicable Points:** Many of the points contained in the first part of this Chapter regarding licensing and technology transfer will apply to franchising, albeit with some adaptations here and there. Likewise, points contained in several other Chapters of this Guide will also be generally pertinent to franchising.

## CHAPTER 7

### **INTERNET BUSINESS: AN OVERVIEW OF U.S. CYBERLAW**

This short Chapter is difficult to write. Covering all or nearly all of the vast subject matter, and doing so in any degree of detail, particularly the legal aspects, would normally require a great deal of space. That is not possible in this Guide and has not been attempted. A relatively few points have been selected and dealt with only in summary fashion.

**The reader is strongly advised to begin by perusing the previous Chapter, Chapter 6, most of which is pertinent to the subject matter of this one. It deals with intellectual property in the USA, licensing in general, licensing of computer software, and related topics.**

- **Protecting Your Own Intellectual Property Used in Cyberspace.** Those will typically be your domain name(s), trademark(s), copyrighted items, and computer software. That point is closely related to the next bullet. On your website, you should insert the proper legends and the like to indicate that you are the owner of the particular intellectual property items (e.g., patents, trademarks and copyrights). If a third party infringes on your copyright, you should notify the site owner in writing, demanding removal of the infringing items pursuant to the 1998 U.S. Digital Millennium Copyright Act (“DMCA”).

- **Not Infringing Third Party Intellectual Property Rights.** You should take care not to infringe anyone else’s intellectual property or similar rights, by use in cyberspace. For example, using without permission another’s trademark or copyrighted item on the internet is usually not a good idea---it can, depending on the circumstances, result in an infringement under U.S. law. The use of a person’s name or likeness without permission (whether or not that person is a celebrity) can infringe his/her “right of publicity” and/or “right of privacy” under U.S. law.

A few additional words about copyright. Copying a third’s party’s copyrighted material (text, images, scripting, programming), without permission can result in infringement, even without knowledge that it is copyrighted. Contributing to or inducing another to infringe can also result in copyright infringement. So can the acts of your employees or agents or other others subject to your control. An internet site operator or service provider can reduce its risks of copyright infringement damages by undertaking certain measures specified in the DMCA. Copyright infringement can have severe consequences, including criminal penalties and potentially substantial civil damages for each infringement, plus bearing the legal fees of the copyright owner, if he prevails in court.

Regarding both copyright and trademarks under U.S. law, there is a defensive “fair use doctrine” that permits someone to use another’s copyright or trademark without infringement. The doctrine is too difficult to define precisely here and we will not try, but only offer some general benchmarks. Unauthorized uses of another’s copyrighted work that promote the public interest, such as education, scholarship, criticism, parody, and others, and that involve copying or otherwise using a relative small amount of the total copyrighted work, might fall within the doctrine. That is particularly so if credit in the copy or reproduction is given to the copyright holder. Whereas, commercial uses of another’s copyrighted work are less likely to benefit, by way of defense, from

the “fair use” doctrine, though there are clearly exceptions to that statement. A fair use defense also exists to certain uses of another’s trademark rights, somewhat similar in general nature to the copyright law’s doctrine.

- **Certain Other Cyberspace Illegality.** Many actions on the Internet are subject to conventional American legislation and legal principals, both with respect to transactions conducted on the Internet and images and text posted there. A few examples are laws on: defamation; fraud gambling, and child pornography, which are regulated in very similar ways on-line as off-line.

- **Privacy Policy and Terms of Use on One’s Own Website; Other Website Concerns.** Care should be taken to see to it that (i) your website Privacy Policy and Terms of Use comply with applicable American law; (ii) both accomplish the particular purposes and goals of the website owner; (iii) the rest of the site otherwise is legally in order; and (iv) the language used in the site is good, American English (assuming the site is intended largely for an American and Canadian audience, or even an audience in the Americas generally).

Terms of Use are similar to pre-printed “General Terms of Sale” used off-line. If you are selling goods or services via your website, your Terms of Use will be a contract documenting the transaction. You will normally want them to contain certain provisions that properly protect you, the website holder.

You may not want your U.S. lawyer who is reviewing your website from a legal standpoint, or creating a Privacy Policy or Terms of Use for your site, to edit your site text for errors in standard American English (grammar, syntax, etc.) . However, that may be inevitable because in the course of such review, your lawyer may note such errors, and it is difficult for him/her not to call them to your attention.

- **Can A Foreign Company’s or Individual’s Internet Activities Subject It to Being Sued in the U.S. Courts ?** That is a complicated question, not capable of a simple “yes” or no” answer. Perhaps the best answer is “yes”, under certain circumstances.

Here are some concepts that bear on that issue. It is not feasible to state them precisely and in full detail in this type of publication. They are only intended to give you some idea of the considerations likely to bear on this question.

Assume a foreign company or its U.S. subsidiary that is not formed in the U.S. State in which a lawsuit is brought (the “Forum State”) and is not registered to do business in that same State. If the sub is formed or registered in that State, or if the foreign company has a registered branch in that State, it becomes a “resident” for jurisdictional purposes and can quite probably be sued there no matter the nature of the particular dispute, whether or not related to its internet activities. We will assume that the foreign company and its sub are not residents of the Forum State but rather “non-residents”.

The critical issue will usually be whether the non-resident foreign company or its U.S. sub (each, the “defendant”) “purposefully availed” itself of the privilege of conducting business in the Forum State by one or more of its own material acts so as to invoke the benefits and protections of its laws.



If the defendant has material “continuous and systematic” contacts with the Forum State then that State will have “general jurisdiction” over the defendant for essentially any type of dispute, whether or not involving internet activities.

Where that is not the case, then one looks to whether the Forum State has “specific jurisdiction” over the non-resident defendant. For that, there must be a substantial connection between the defendant’s “purposefully directed” contacts with the Forum State and the operative facts of the particular litigation.

Assuming a “specific jurisdiction” type situation, some American courts apply a sliding scale to determine whether cyberspace contacts with the Forum State will justify that State exercising personal jurisdiction over the non-resident defendant. At one end of the sliding scale is a “passive website” that merely advertises on the Internet. Such ads, accessible to anyone in the world connected to the Internet, probably do not rise to the level of “purposefully directed” contacts with the Forum State, and probably are not sufficient minimum contacts to justify its exercise of personal jurisdiction over the defendant, even if the litigation is directly connected to that website. At the other end of the scale is a website through which the owner does Internet business by entering into contracts with Forum State residents by knowingly transmitting computer files over the Internet. If the claim or dispute arises out of that or those contacts, the chances are fairly substantial that the Forum State will find there to be “specific jurisdiction” over the non-resident defendant. In between are those websites with some interactive elements enabling a visitor to exchange information with the host computer. It is difficult to predict whether use of an “in-between” site that involves some contact with persons in the Forum State (and a dispute with one of them arising out of such contact(s)) would be sufficient to permit that State to exercise personal jurisdiction over the non-resident defendant.

There is no guaranty that courts in all U.S. states will apply the above sliding scale concept regarding website or cyber contact. American law in this area continues to evolve.

Even if the court finds there to be “general jurisdiction” or “specific jurisdiction”, that is not the end. Other criteria that must be met for the court to proceed with the case, which are beyond the scope of this Guide to explain.

- **U.S. Tax Aspects of Internet Sales: An Overview**

### **U.S. Income Tax:**

See Chapter 9 generally for an overview of taxation and particular points not covered below.

#### **Federal Income Tax**

If the internet seller is a U.S. corporation (one formed in the USA), it is subject to U.S. federal income tax on its worldwide income, including from internet sales. The same is true for a U.S. limited liability company, except that the LLC owners are responsible to file tax returns and pay the taxes due (the LLC being a tax pass through entity).

If the internet seller is a foreign entity or person, and there is a income tax treaty between his/its country and the USA, normally the seller will not be liable for US federal income tax its internet sales unless it has a “permanent establishment” in the USA (“PE”) with which the internet sales income is effectively connected. If there is no such tax treaty, then rather than “PE”, the issue becomes whether the seller has a US trade or business with which that income is effectively connected, in which case it is taxable. It is not clear whether a website itself can constitute a PE or trade or business in the USA. If the server is based in the USA, that might be a factor. If the server’s host is located in the USA, that might possibly be enough, depending on overall scope of the host’s functions for the internet seller.

### State Income Tax

If the internet seller is a U.S. corporation or LLC, and has a place of business or a sufficient physical presence in a particular US state from which it makes internet sales to persons in that same state, it will normally be liable for that state’s income tax on those sales. In general, the same is true for a foreign entity or physical person.

### **Sales and Use Tax:**

Regarding sales and use taxes generally, see the bulleted heading “Sales and Use Taxes” in Chapter 9.

Sales tax applies, in general, to sales of non-exempted tangible personal property and possibly certain services, depending on the particular state or municipal law.

As a general rule, if your business is physically located in U.S. State 1 and

- it sells over the internet to a consumer (retail buyer) in that same State, you are probably responsible for collecting and remitting to the State 1 its sales tax on the transaction;
- it sells to a retail buyer in U.S. State 2, probably you are not responsible for collecting sales tax. However, if your business has a “nexus” (which in layman’s terms roughly corresponds to “physical presence” of some significant sort) within State 2, then you may be required to collect the sales tax due in State 2. Maintaining an office, or good inventory, or extensive marketing or promotion, or having employees or even possible sales agents, in State 2, could be enough of a nexus.

If your business is physically located in State 1 and you sell via your internet site, you will normally be considered to be located in that State for sales (and use) tax purposes, even if your internet server and place of shipment of the goods are outside of State 1. With few exceptions, that means you are subject to the sales and use tax laws of the taxing authorities in State 1.

Sales of computer software, whether via the internet or not, may or may not be subject to sales (and use) taxes. That will depend on the particular legislation. Some jurisdictions make a distinction between pre-packaged software and custom made software.

Use tax can result from out-of state purchases of non-exempt tangible personal property and certain other items from sources such as internet sites not intended for the buyer’s resale but its use, storage or consumption. “Out-of-state” generally means outside of the U.S. state in which the purchaser has

its place of business (physical presence of some sort, as above).

Sales and use tax, including on internet sales, are complicated areas and can, if you, in fact, are determined to have an obligation to collect and remit and do not, result in significant liability. The laws on collecting and remitting these taxes vary from state to state.

A few disclaimers are in order. First, the sales and use tax area, particularly regarding internet sales, are fact specific—they depend on the particular situation. Second, the sales and use tax laws vary from state to state and are subject to change possibly more than fields. Third, if you think you might possibly be subject to sales tax and use tax, consult an expert.

## CHAPTER 8

### **BUYING AN EXISTING U.S. COMPANY OR A PART OWNERSHIP THEREOF**

“Bullet points” are really not appropriate for this complicated and multi-faceted subject. There are many types and varieties of acquisitions and acquisition structures, and for each, there are many facets and key points. Mentioning all or even many of them is impossible due to space constraints. Here are a few short and rather general observations about acquiring a U.S. company or a part ownership therein.

- **“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.
- **Stock Purchase; Assets Purchase.** Most acquisitions of privately owned companies will be by way of either a stock purchase or an assets purchase. Potentially, each has its particular upside and downside features for the buyer and the seller. You should be aware of them.
- **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.
- **The “Antitrust” Law Aspects.** Where the acquisition is fairly sizeable, the U.S. antitrust aspects should be evaluated before proceeding too far with the negotiations. Also, for fairly sizeable acquisitions, a pre-notification filing with a U.S. government antitrust watchdog agency will be required.

- **The Tax Aspects.** Before proceeding too far with negotiations, the buyer's experts should study the tax aspects of the proposed target company. They may affect the manner and structure of the deal the buyer wishes to negotiate.

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More extensive information on acquisitions of a U.S. business or a part thereof can be found in "*A Foreign Person's Guide to U.S. Law – Business Practice – Taxation*", or in "*The Acquisition of an Existing American Company or an Ownership Interest Therein: A Short Practical Guide for the Foreign Business Person and Foreign Lawyer*" both by this author and available from him at no cost. See the Annex at the end of this Guide. .

## CHAPTER 9

### AN OVERVIEW OF U.S. TAXATION

This Chapter discusses by way of overview the U.S. tax system and some of the important tax considerations for investors, exporters, licensors etc. to consider. Certain tax points have been made in other Chapters of this Guide.

- **Introduction.** The United States is a federal republic; that is to say, the national government, each state, and the local government within each state makes its own laws and has its own courts. Therefore, each government has its own tax administration, its own tax laws, and its own tax forms. At the federal level, there is income tax, including corporate and personal income tax, capital gains tax, income tax on dividends, interest and royalties, and on partnership profits; and employee payroll taxes. At the state level, there are, in most states, similar taxes as the above federal ones; and sales and use taxes. Some counties and cities have their own tax regimes, e.g., income and business taxes and property taxes. New York City is one.

The more important American taxes and the authorities which impose them are shown in Annex 1 to this Chapter. The U.S. federal income tax rates on corporations are contained in Annex 2 to this Chapter.

The USA enters into separate international agreements with many countries for the purpose of avoiding double taxation and preventing fiscal evasion with respect to taxes on income (they are often called “income tax treaties”). Some of these treaties are rather complicated, one example being the rather intricate provisions on activities which can cause a foreign resident company or individual to have a "permanent establishment" in the USA and those which will not cause such a result. Those income tax treaties apply to U.S. federal income tax (and the income taxes of the other treaty country). **The provisions of the relevant treaty or treaties are often important tax planning tools and for determining what taxes will be due.**

Also, before entering into a venture in the USA, a foreign exporter or investor should determine which taxes may be due to states and municipalities. These are not covered by income tax treaties. Because of the USA's size and the diversity of local laws, the total amount of taxes may differ significantly from one location to another.

- **PE in the USA.** As a general principle, the U.S. tax laws seek to impose a tax on every company that is considered to be doing business in the USA. Most U.S. income tax treaties exempt resident companies and individuals of the other treaty country from U.S. federal income taxes on business profits if they do not have a PE in the United States. A PE is defined therein. A PE in the USA under many of the US tax treaties typically includes a fixed place of business such as a seat of management, branch, an office, a factory, a workshop or a warehouse, used to conduct business in the USA. It also frequently includes a mine, quarry or other place of natural resource extraction in the USA maintained by the foreign resident party; and a building site or construction or installation project of the foreign resident existing in the USA for more than a certain number of months.

If a foreign exporter appoints an American company as its exclusive distributor and delivers all

goods f.o.b. non-U.S. port, normally no U.S. income tax liability arises for the foreign exporter on the profits from its sales to the distributor.

If, however, a foreign company believes that it can sell its products better by having its own marketing group in the U.S. or at least having its trained personnel in the USA to assist in the marketing, the company may be considered to have a PE in the USA and be subject to American income tax on the income resulting from the PE and any other U.S. source income effectively connected to the PE.

Some other acts and actions that might give rise to a PE in the USA under many U.S. income tax treaties are:

- You set up a branch marketing sales or marketing office of your company in the USA (whether or not the branch is formally registered).
- You give your U.S. agent the authority to accept purchase orders from your customers or otherwise allow him to do so.
- Your agent uses business cards which list him as a manager for your company. (He holds himself out to the public as an employee of your company.)
- You send your employee to live in the U.S. to help your agent or distributor with technical or marketing problems, or to operate out of your (unincorporated) U.S. sales or marketing office.
- You agree to pay part of the rent of your U.S. agent's or distributor's office or telephone expenses and have your company name listed in the local telephone directory.

The foregoing are examples only---many others could be cited.

U.S. income tax treaties typically list certain activities which will not result in the foreign resident company having a PE in the USA. These may include (depending, of course, on the terms of the particular treaty): (1) exporting to the USA without any fixed place of business in the USA or without a U.S. agent that regularly accepts orders for goods to be sold; (2) utilizing a U.S. corporation, that is, one incorporated under the laws of a U.S. state, to conduct the U.S. business (e.g. manufacture or purchase of goods from the foreign parent and sale or resale thereof to U.S. distributors, dealers and customers; or sale of services); (3) use of U.S. facilities for, or the maintenance in the USA. of, a stock of goods belonging to the foreign enterprise for storage, display or delivery of such goods for their processing by a third party; (4) maintaining a fixed place of business in the USA for purchasing goods, collecting information for the foreign enterprise, or for activities of a preparatory or auxiliary character (e.g., advertising or scientific research); and (5) the maintenance by the foreign enterprise or individual of a building site or construction, assembly or installation project in the USA which does not exist for more than the number of months specified in the relevant tax treaty.

The foregoing rules are stated in a general way. Income tax treaty provisions are rather detailed and contain many subtleties. The foreign company's proposed activity in the USA should be carefully reviewed in advance to determine whether a "PE" in the USA is a material risk for you, and the likely consequences of having one. In general, most foreign companies and individuals will want to avoid having one.

- **Claiming Tax Treaty Benefits.** Foreign companies and individuals that claim the

benefits of particular provisions of a tax treaty to override provisions in domestic U.S. federal income tax law, must disclose the treaty-based provision in a federal income tax return. This applies whether or not the foreign party was otherwise required to file a U.S. federal income tax return. Non-compliance can involve potentially very large penalties.

- **No Applicable Income Tax Treaty.** There will be situations where no applicable income tax treaty exists between the foreign party's home country and the USA. In that situation (1) the foreign party should avoid acts and activities that will cause it to be doing business in the USA for US federal income tax purposes; and doing business in any particular U.S. state for purposes of its income tax; and (2) creative, advance tax planning will often be required.

- **Branch, LLC or Corporation.** When the foreign company decides to have its own U.S. operation, it must also decide whether it should function as a U.S. branch of the foreign company or as a separate U.S. legal entity (like a corporation or LLC) organized in one of the states in the U.S.A. If you expect the early years of the U.S. operation to show losses, you might give consideration to operating a branch. This may be advantageous from a foreign income tax standpoint. However, the U.S. imposes a branch profits tax on the deemed repatriated earnings of the branch. This, in effect, equalizes the tax treatment of a U.S. branch and a U.S. subsidiary corporation or LLC. Based on this author's experience, if you intend to market your products or services in the United States, the formation of an American corporation is in many if not most cases the route to select. Operating through a "branch" is too risky from several standpoints, including liability. And, the LLC (limited liability company) has several important drawbacks, particularly for a foreign-owned one. **See Chapter 3 for a more specifics.**

- **Taxation of "Corporations": U.S. Federal Income Tax.** A corporation formed under the laws of a U.S. state is subject to U.S. federal income tax on its worldwide income. The tax is levied on its net taxable income, which is essentially its gross income minus allowable deductions. A corporation's taxable income and federal income tax are computed essentially as follows:

book gross income  
 +/- adjustments and deductions  
 = taxable income  
 x applicable corporate tax rate  
 = amount of tax  
 - applicable credits  
 = final tax liability.

The annual accounting period selected by a U.S. corporation is its taxable year generally, and is normally the same as its financial year.

- **Alternative Minimum Tax.** To the extent that its application results in a higher tax than the regular corporate tax, an alternative minimum tax ("AMT") is imposed in lieu of the regular corporate tax. Certain so-called "tax preference" items are added back to the corporation's taxable income to arrive at the corporation's alternative minimum taxable income. The AMT is intended to assure that all U.S. corporations with substantial economic income pay federal income tax notwithstanding exclusions, deductions and credits otherwise available by law. The AMT makes for additional complexity and more record keeping. Corporations with relatively



low gross receipts may be exempt from AMT for its initial year or possibly initial years of operation.

- **Consolidated Tax Returns.** A group of U.S. companies consisting of a U.S. parent company and its at least 80% owned U.S. corporations may be taxed on their consolidated income, by filing a consolidated federal income tax return. In such cases, dividends paid by the U.S. affiliated companies to their U.S. parent company are exempt from U.S. federal income tax.

- **Transfer Pricing.** The American tax authorities are concerned that profits between the foreign parent company and its U.S. subsidiary or affiliate may be shifted from the U.S. to the foreign country. This would be the case whenever the parent company invoices the subsidiary at a higher price than would be charged a third party. Under Internal Revenue Code ("IRC") Section 482, the government has the right to change the prices charged by the foreign parent company to the U.S. affiliate, if it believes that they do not reflect the proper amount. That is the amount which would be charged in an "arms length" transaction between unrelated parties. As an exporter this normally means that you must be able to prove to the tax authorities that the price you charge to your branch, subsidiary or affiliate in the United States is the same as you charge an unrelated third party. Other charges such as interest on loans, license fees, royalties and management and other service fees between related parties are also included in IRC Section 482 must be carefully conceived to avoid tax problems. Provisions more or less paralleling IRC Section 482 are found in many US income tax treaties.

A foreign company can also encounter U.S. customs problems when it invoices a related party at too low a price.

- **Interest, Royalties and Service Fees between Related Companies.** Royalty and interest payments from a U.S. resident payor to a foreign payee will, as a rule, be subject to a flat 30% U.S. withholding tax. Tax treaties to which the U.S. is a party either reduce the rate or eliminate the withholding tax. Normally a U.S. corporation can deduct these from its income as business expenses. Under U.S. federal income tax rules, a corporation's ability to deduct interest paid to a related party can, under certain circumstances, be substantially curtailed if the related corporation is not subject to U.S. income tax on the interest income. As remarked above, similar potential problems exist for royalty and service fee payments between related parties.

- **Debt/Equity Ratio.** Care must be taken to assure that a proper and acceptable relationship between debt and equity for foreign-owned U.S. corporations is maintained. If the tax authorities can establish that the debt is too high in relation to the stockholders' equity, they can treat the interest payments as dividends and can as well consider the principal repayments as dividends. The result of this determination has the effect of increasing the taxable income of the U.S. corporation by the disallowance of the interest expense and application of income and/or withholding tax on both the interest and principal repayments.

- **Real Estate (Immovable Property).** Many years ago, it was possible for a foreign individual or company to escape all U.S. taxes when real property was sold in the United States at a profit. One reason for this was that some tax treaties exempted such transactions. Several years back, that was changed. If a foreign company or individual sells real property located in the

United States, a U.S. withholding of 10% of the sales price applies. The seller has to effect the withholding and pay the money to the IRS. The purpose is to assure that the income tax due on the gain from the sale will be collected.

- **Accumulated Earnings Tax (“AET”).** This is a penalty tax applicable if the authorities believe that the U.S. corporation is not sufficiently distributing its earnings to its shareholders (thus avoiding their being taxed on dividends), but rather keeping the funds in the business beyond its reasonable needs. At this writing, the AET is 15% of the corporation’s accumulated taxable income.

- **Dividends.** Shareholders are normally subject to U.S. income tax on dividends. Non-U.S. shareholders are subject to U.S. withholding tax on dividends received from a U.S. company (normal rate 30%) which may be reduced by the applicable income tax treaty (if any).

- **Net Operating Loss Carryback/Carryforward.** If the U.S. branch or corporation has an operating loss in any year, this loss can be offset against prior income as well as any future income. Generally, it can be carried back first to the two years preceding the loss year, then forward to the twenty years following the loss year. The taxpayer can, by filing an election, waive the entire carryback period whereupon the NOL can only be carried forward.

- **Financial Statements.** There are differences between a financial statement prepared on the basis of generally accepted accounting principles and tax returns prepared in accordance with the U.S. Internal Revenue Code. Some items that may cause these differences are depreciation, foreign exchange gain or loss, and intangible drilling costs. Reserves for future expenses and other contingencies are not allowed for income tax purposes, nor are valuation reserves. A reserve fund for bad debts, however, is permitted, both in the financial statements and the income tax returns.

The affairs of a company are considered private and, therefore, there is normally no requirement to publish its financial statements, unless the shares of the company are publicly held and are thereby subject to the rules and regulations of the U.S. Securities and Exchange Commission.

- **State Corporate Income Tax; New York City Corporate Tax.** Nearly all U.S. states have an income tax on corporations, normally applicable to income attributable to that particular state. The rates range per state from around 1% to around 10%. For corporations conducting business in New York City, there is a corporate tax calculated by one of several methods, the top rate being at this writing 8.85%. The paid taxes can be deducted on the corporation’s U.S. federal income tax return.

- **Payroll Taxes; Voluntary Expenses.** Most companies pay certain payroll-type taxes, which, as a rough rule of thumb, will total around 10% of their employees’ salaries and wages. In addition, they may incur voluntary expenses for medical care, disability insurance, life insurance and retirement plans of their employees. In total these costs will probably range roughly from around 15% to 25% of salary and wage payments.

- **State Sales and Use Taxes.** Many states and municipalities collect “sales taxes” on retail

sales and “use taxes”, with different rates in effect from one location to the next. Each tax authority establishes which goods and services are subject to sales tax and use tax, and establishes the procedures to be used for registration, collection and payment of the taxes due.

If the company is not doing business in a particular U.S. state, it is usually not obligated to collect sales tax on sales within that state. On the other hand, if the state laws consider your activity as doing business in the state and your company sells and delivers a product to the final user within the state, you must collect the sales tax from your buyer, file the required tax returns and pay the tax to the state or municipal tax authority. This can be quite cumbersome if the company is doing business in many states.

Generally, non-exempted tangible personal property purchased outside of the buyer’s home U.S. state (e.g., the one in which it is doing business) and brought back into it, on which the out-of-state seller has not collected sales tax at least equal to the home state’s use tax, is subject to the home state use tax. Typically, out-of-state purchases of tangible personal property intended for resale by the buyer are exempt from home state use tax, whereas if it is for use or consumption by the buyer, it will apply (but subject to the preceding sentence and absent some other exemption).

- **Individual Income Taxes.** The rates vary, depending on whether the person is married, single or unmarried head of household. The amount of income tax can vary depending on which state of the U.S.A. one works in and where one lives. A small handful of the fifty states have no personal income tax for individuals.

For U.S. tax purposes, the rule is that a foreign individual who is considered to be a U.S. tax resident is subject to U.S. income tax on his or her worldwide income. An individual is deemed to be a resident of the U.S.A. for purposes of U.S. federal income tax if

- he or she holds a U.S. permanent resident visa ("green card"), or
- he or she was present in the U.S.A. for at least 183 days during the latest tax year. Even if the above tests are not met, if the individual was present in the USA in the latest tax year for at least 31 days, then the following formula is applied: number of days present in the USA in the latest tax year, plus 1/3 of the total days present in the USA during the immediately preceding tax year; plus 1/6 of the total days present in the USA in the tax year immediately preceding that one. If the total is at least 183 days, the person is considered to be a resident for U.S. federal income tax purposes for the latest tax year. This is hereafter referred to as the "cumulative days test". Thus, if Mr. X, a citizen of a country other than the USA, was present in the USA for 160 days in the latest tax year, 54 days in the immediately preceding year and 30 days in year before that, the calculation would be 160 plus 18 (1/3 of 54) plus (1/6 of 30), totaling 183 days. Mr. X would be considered a resident for U.S. federal income tax purposes for the latest tax year, unless it is established that he has a closer tax connection to another country (e.g., the country of which he is a citizen). The cumulative test is avoided if the foreign national is not present in the USA for more than 121 days during any calendar year; or, as stated above, if he establishes that he has a closer tax connection to his home country than the USA, based on the relevant facts and circumstances. The length of the alien's permitted U.S. stay under his non-immigrant visa may be influential in connection with the closer tax connection test.

If the employee not treated as a U.S. tax resident earns compensation for his services from his U.S. employer, that income, because it derives from a U.S. source (and certain other types of

U.S. source income), will normally be subject to U.S. income tax at the same rates as a U.S. citizen or permanent resident would pay but is permitted only limited deductions. As a tax non-resident, he is not subject to U.S. income tax on his non-U.S. source income.

## ANNEX 1

### The more important taxes levied in the USA

Type	Federal	State	Municipalities
Income tax	X	X	X
Wealth tax	None	None	None
Value added tax	None	None	None
Turnover/sales tax		X	X
Estate and gift taxes	X	X	
Old Age Benefits tax	X		
Unemployment Insurance tax		X	X
Disability	X		
Real property tax			X
Personal property tax		X	

## ANNEX 2 U.S. Federal Income Tax Rates on Corporations (2008 and 2009)

Taxable income over	Not over	Tax rate
\$ 0	\$ 50,000	15%
50,000	75,000	25%
75,000	100,000	34%
100,000	335,000	39%
335,000	10,000,000	34%
10,000,000	15,000,000	35%
15,000,000	18,333,333	38%
18,333,333	.....	35%

## CHAPTER 10

### U.S. BUSINESS-RELATED VISAS FOR FOREIGN 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 certain foreign 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.

Below is a brief summary of most of the above visa types. In any particular situation, the details and specifics of both that situation and the visa type(s) being considered must be closely examined to determine which is appropriate.

- **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 necessarily be granted for a particular stay). There is a “visa waive program” applicable to nationals of particular countries permitting them to stay in the States for up to 90 days without a B-1 (or B-2 visitors for pleasure) visa. However, holding a B-1 visa can be advantageous in certain circumstances.
- **L-1.** This visa is for a foreign 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 person seeking an L-1 does not have to be a national of the same country as the country in which the foreign enterprise is formed. Thus, the person can be a U.K, French, Brazilian, Swedish, Japanese, Indian, Chinese etc. national and the foreign enterprise, one formed in the another country. The L-1 is tied to the particular U.S. employer (subsidiary, branch or affiliate of the foreign company), meaning that the holder cannot work for another U.S. employer. By filing a special application, the spouse of L-1 visa holder can receive a visa permitting the spouse to work in the USA.

- **The “H” Category Visas. 1. The H-1B:** 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. State licensure, if required to practice in that field, is also necessary. Applying for and receiving labor certification from the U.S. Department of Labor is also required for the H-1B. In the application, the employer must attest that wages offered are at least equal to the actual wage paid by the employer to other workers with similar experience and qualifications for the job in question, or alternatively, pay the prevailing wage for the occupation in the area of intended employment, whichever is greater. Employers are not required to seek and advertise for local talent before—foreign H-1B workers can be hired even when a qualified U.S worker wants the job, and a U.S. worker can be displaced from the job concerned in favor of a foreign worker. The H-1B visa is tied to the particular employer seeking the visa for the individual, meaning that the visa holder cannot work for another U.S. employer. Members of the immediate familiar of the visa holder (spouse and children under 21 years of age) receive H-4 visas but cannot work in the USA. There are annual numerical caps for H-1B visas. The normal duration of H-1B stay is 3 years, extendable to 6 (and possibly beyond under particular circumstances). **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-1B, 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.
- **E-1 (“Treaty Trader”).** The E-1 is only available for nationals of countries that have concluded a particular type of treaty with the USA granting access to it. Thus, one must first determine if the E-1 is available to the particular foreign national. The E-1 is predicated on a company from such a treaty country having a U.S. subsidiary, affiliate or branch (“US Operation”). The individual 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 50% of the foreign company (and, if the 50% or more ownership is through one or more legal entities, one looks to the nationality of its or their owners). The individual seeking the visa must be coming to the USA to carry on that business.

Generally, the US Operation will have to have been in operation for about a year. The E-1 holder can be paid for his/her services from the US Operation's payroll. Spouses of E-1 holders are eligible, by obtaining prior authorization, to work in the USA. There are no quotas for E-1s.

- **E-2 (“Treaty Investor”).** The E-2 is available only to nationals of a country that has a particular type of treaty with the USA according access to it. As with the E-1, one must first determine if, in the particular situation, the E-2 is available at all. The key for the E-2 is the amount of “capital” the foreign company or 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 foreign 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 manage the US Operation. As with the E-1 (Treaty Trader) visa, nationals of the foreign treaty country must own at least 50% of the treaty country company. The E-2 holder can be paid for his/her services by the US Operation. Spouses of E-1 holders are eligible, by prior authorization, to work in the USA. No quotas exist for E-2s. E-2s are typically granted for an initial 2 year period; extensions can normally be obtained fairly easily.
- **Permanent Resident Visa (“Green Card”).** The requirements for a “green card” will not be discussed here for lack of sufficient space. The following points are noteworthy: 1. A foreign 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 in the USA on his/her worldwide income.
- **Permanent Resident Visa Based on a Substantial U.S. Investment (Visa EB-5):** This is a special type of permanent resident visa. It is for a foreign national that make a major investment in a “new U.S. enterprise”. The new U.S. enterprise can be a newly created one, or the expansion of an existing one, or one resulting from the purchase of an existing U.S. business and its restructuring or reorganization. The applicant must invest at least US\$ 1 million in the new U.S. enterprise (US\$500,000 in certain exceptional cases). He/she must show a benefit to the U.S. economy and satisfy certain other requirements and criteria regarding employment, new job creation and certain others.

## CHAPTER 11

### LITIGATION AND ARBITRATION IN THE USA

#### GENERAL COMMENTS AND PRINCIPLES

! **Americans' proclivity to start lawsuits or threaten to do so.** Americans are, in general, inclined to start litigation or to threaten it - probably more so than just about anyone else. It is not just American lawyers that exhibit this tendency, but also (and particularly) American business people---in fact, Americas generally. The common expression *Asue 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 this author's 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 not feasible to prosecute 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 arbitrator(s) outside of the USA. A commercial arbitral award rendered outside the USA can normally be enforced in the USA if the foreign party is from a country that adheres to an international arbitration convention to which the USA also is bound. Nevertheless, experience has shown that the enforcement procedure is rather complicated and costly as compared to the enforcement in the USA of an arbitral award rendered within the USA. 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 party. 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 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. 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 advantages of having only one arbitrator include: lower costs (one pays the arbitrators); and it is normally easier to get things done, as compared with three arbitrators who may not be readily available for hearings, decision making and other procedures. The American Arbitration Association ("AAA") employs a "list procedure" to select the arbitrator(s) if the parties have not agreed on the arbitrator(s) or another method of selecting them. The AAA arbitrator list normally contains qualified persons, and the list procedure itself works reasonably well in most cases. As stated above, the AAA has arbitrators available in a considerable number of countries.

The following contractual provisions may, in a particular case, be beneficial to the foreign party:

! 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 foreign 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.

! 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).

! 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.

- 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.

- 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, the foreign party's U.S. distributor, agent, licensee or the like (the “U.S. contract partner”) in a US court---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 contractual arbitration provisions are properly drafted, it may be possible to avoid that. In other words, they might require the U.S. side to initiate arbitration under the arbitration clause to pursue its product liability claims against the foreign party.

## **PARTING COMMENTS**

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.

## **CHAPTER 12**

## **ERRORS FREQUENTLY MADE BY FOREIGNERS**

Foreigners 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 booklet to list all the errors that foreigners tend to make. Many have already been mentioned in previous Chapters. A few deemed particularly noteworthy are listed 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 foreign 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 serious 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 hereto. 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 foreign company ("FCo") engaged what its owner ("FCo Owner" or "Owner") believed to be an old friend to work for the U.S. subsidiary corporation that FCo intended to form ("USCorp"). The "friend" told the FCo 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. FCo and its Owner intended that 1 share of USCorp's stock be issued to FCo 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 FCo or a trust beneficially owned by FCo (whichever FCo should decide later). FCo Owner believed he had conveyed that information to the "friend" and that he understood and was in agreement. **No written contract between FCo, FCo 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 FCo 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 FCo Owner, one of its two Board of Directors' members. The substantial moneys (capital) invested in USCorp came from FCo. US Corp meanwhile signed a lucrative, fairly long term contract with a major U.S. customer to purchase FCo's products from USCorp. FCo 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 FCo 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. **The guides cited at the end of this chapter explain what those benefits are.**
- **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.**
- **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.

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**For more information and other examples of errors frequently committed by foreigners, see the author’s “*A Foreign Business Person’s Guide to American Law - Business Practices - Taxation*”, copies of which are available at no cost. Another text, also available gratis from Mr. Wise, dealing with properly drafted General Terms of Sale for the U.S. and most export markets generally, is “*General Terms of Sale for Exports to the USA, the Western Hemisphere Generally, and Worldwide: A Guide for the Foreign (Non-US) Exporter.*”**



## ANNEX

### THE AUTHOR'S OTHER COST-FREE PUBLICATIONS RELATING TO THE USA

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

*A Foreign Business Person's Guide to American Law – Business Practices - Taxation*

*American Product Liability: “Good News for Business!” Recent Trends and Developments---  
A Guide for Foreign Companies*

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

*Placing Your Goods “On Consignment” with Your American Business Partner: What the  
Foreign Exporter and its Financing Bank or Factor Should Know*

*Debt Collection: Will United States Courts Recognize and Enforce Foreign Country  
Judgments?*

*The Acquisition of an Existing American Company or an Ownership Interest Therein:  
A Short Practical Guide for the Foreign Business Person and Foreign Lawyer*

*Purchase and Leasing of Real Property in the United States*

The co-author is David Berkey, Esq. Partner of Gallet Dreyer & Berkey, LLP, New York City, the same law firm as Mr. Wise.

**NOTES:** Some of the above publications are available in languages other than English. Most of the above guides, and various others, can be printed and downloaded from the author's law firm website, [www.gdblaw.com](http://www.gdblaw.com). On the home page, click on “Practice Areas”; on the next screen, click on “International” and right under it, click on “Publications”. They can also be obtained upon request from the Author.