K&L GATES

DOING BUSINESS IN THE UNITED STATES

A Guidebook for Non-US Companies Operating in the United States

INTRODUCTION

The purposes of this guidebook are to identify and briefly discuss selected key US legal and regulatory issues commonly faced by non-US companies commencing, continuing, or expanding operations in the United States. Anticipating and dealing appropriately with these issues can contribute significantly to success in doing business in the world's largest economy.

Topics covered in this guidebook are not exhaustive and frequently prompt inquiries into other related issues. For the purpose of providing examples of certain concepts this guidebook references various laws and regulations of the State of Delaware. These may vary from the laws and regulations of other US states.

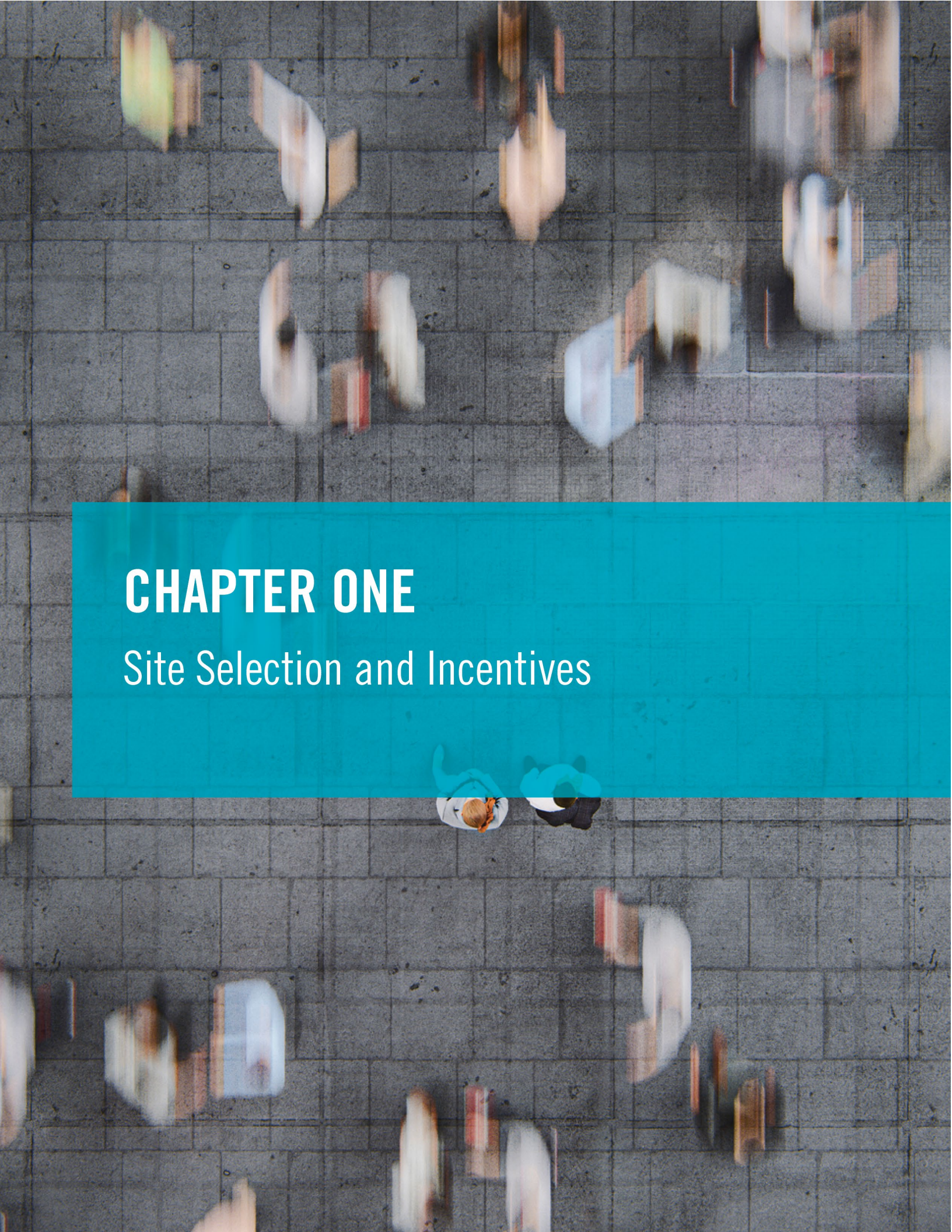
K&L Gates' lawyers are experienced in representing international clients making investments and conducting operations throughout the United States. K&L Gates advises on US and non-US legal and regulatory issues in a broad array of transactions and matters across industries and sectors that include the following:

- Consumer Goods and Services
- Energy
- Financial Services
- Healthcare
- Life Sciences
- Manufacturing
- Technology
- Transportation and Logistics

Visit klgates.com for more information regarding K&L Gates' legal services and offices in the United States, Asia, Australia, Europe and the Middle East.

This guidebook is not intended to be, and does not constitute, legal advice with respect to the matters discussed and should not be relied on for that purpose. It is, by its nature, general in scope. Readers of this guidebook should consult with a lawyer regarding the legal implications of any particular facts or circumstances.

CONTENTS



CHAPTER ONE

Site Selection and Incentives

Chapter One -

SITE SELECTION AND INCENTIVES

A. Introduction

America is the world's largest national economy and leading global trader. An important element of that global leadership is providing access for non-US companies to US markets with minimal impediment. While competition in the United States is healthy and spirited, US businesses and business communities are receptive to non-US companies entering US markets. This chapter will discuss the site selection process and potential economic incentives that may be offered to inbound companies. This chapter also discusses important information available to companies inbound to the United States, as well as cultural differences that may be experienced at the new location.

The US Department of Commerce, through its SelectUSA program, is the primary federal agency involved in providing important information concerning various aspects of doing business in the United States. Contact information for SelectUSA is listed on its website at www.selectusa.gov/welcome.

State and local governments also have economic development agencies that promote foreign company investment and operations. Those agencies can provide a wealth of knowledge about opportunities in their respective states. Information about these agencies is readily available through the Internet.

Once a company has decided to move to or expand in the United States, it should begin the process of selecting the best location for its new project. Relationships with state and local government economic development agency officials are vital. A company might benefit from working with an experienced consultant, such as K&L Gates, to guide its executive management team through the location selection process quickly and efficiently, saving time and money while reducing its risk and managerial burden. This approach also may eliminate the need for a real estate broker, potentially saving the company significant amounts in brokerage fees and commissions.

B. Location Strategies and Economic Incentives

Working with an experienced consultant such as K&L Gates to build a strategic site selection plan is essential for manufacturing and industrial companies seeking to relocate facilities, expand into new markets, or develop additional capacity at existing locations anywhere in the United States. Site selection is the process of choosing a location for a company’s new project, whether it is an existing building or land for new construction. Selecting a location in a community that supports the company’s vision for growth and expansion, and is willing to incentivize that effort, is crucial to the success of a project. Some state and local communities in the United States provide incentives for businesses that are relocating to, or significantly enhancing their presence in, those jurisdictions. In fact, the competition among the states and counties is so fierce that companies have the opportunity for significant cost savings dependent upon the scope of their US project.

Economic incentives provide a valuable resource to companies and may help reduce the costs of opening a new or expanding an existing business facility. Working with a consultant such as K&L Gates that has a comprehensive knowledge of the potential incentives and how they interconnect is critical. Some examples of incentives are subsidies, tax credits, discounts, cashbacks, job training and recruitment, as well as joint ventures or similar arrangements with local colleges and universities. As the goals of

business and government become more aligned, discretionary economic incentives have increased in popularity. These discretionary incentives may be used as tools to address a gap in project funding by providing free land and other valuable resources. Some incentives are focused on rapidly changing challenges ranging from labor and supply chain issues to infrastructure solutions. These discretionary incentives may include the following:

- No-cost or low-cost land and buildings;
- Grants and reimbursements;
- Infrastructure such as utility upgrades and installation, roads, lights, and site grading and clearing;
- Expedited permits for construction, environmental and operation; and
- Workforce recruitment and training.

I. Background

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

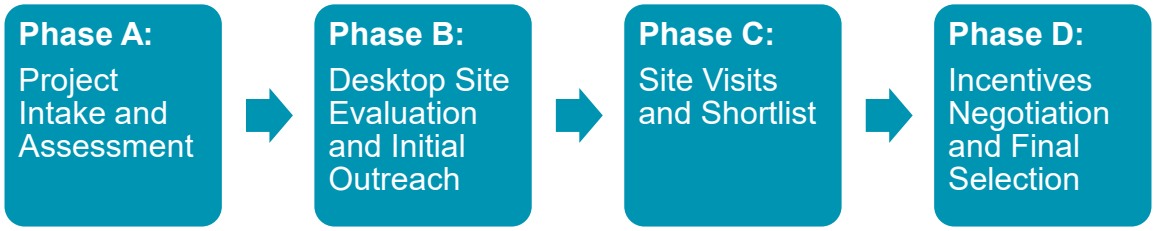
- Number of net new jobs;
- Wages/salaries of those positions on an individual location basis (not averaged across the entire workforce);
- Amount of capital investment (land, buildings, machinery and equipment); and
- Specific geographic location within the particular state and/or county.

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

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

II. Site Selection and Incentives Process

How does an experienced consultant like K&L Gates work collectively with companies?



Phase A: Project Intake and Assessment. The most important step in the site selection process is partnering with an experienced legal consultant such as K&L Gates to conduct a needs assessment and project intake. The primary goal is to work together to chart a solid understanding of the project's parameters and the factors that are integral to the company's decision-making process. Typical topics for consideration include power and water capacity, labor requirements, proximity to key customers or suppliers, facility specifications, time zone constraints, desire to lease or purchase an existing building or engage in new construction, and industrial clusters. Once the needs assessment is complete, the company can begin to eliminate certain geographic areas and develop a shortlist of suitable target states or regions.

Phase B: Desktop Site Evaluation and Initial Outreach. After the consultant performs a property search and desktop evaluation, the consultant will usually make the initial communication with their contacts in the targeted states or geographic areas of interest. This communication is typically done through a phone call along with a formal Request for Proposals (RFP). The RFP contains general information about the company, the project parameters, and the decision drivers. The company's consultant typically delivers the RFP under a project codename, since companies typically do not reveal their identity at this stage. Based on responses to the RFP, the company and its consultant then further narrows the target list to specific communities and properties that meet the company's parameters.

Phase C: Site Visits and Shortlist. The company and its consultant spend a few days on the ground visiting the narrowed list of sites and buildings (typically spending 24 hours in a specific community). These visits generally include, among other things, introductions to utility providers, presentations on workforce, community familiarization, livability, infrastructure, and state and local incentives. At this stage, the company typically reveals its identity to the state and local officials.

After the site visits, the company again narrows its list to one leading candidate in two or three states or locations. The most advantageous site is the site that achieves the targeted balance of geography, labor availability, local infrastructure, supply chain networks, operational costs, and economic incentives. Certain key points to consider when selecting a site are:

- Should you consider multiple states for a competitive process?
- Which location best serves your supply chain?
- Is a skilled workforce available?
- Will you have the right infrastructure?
- What is the source, capacity and service capability of the utilities?
- Are your utility requirements met?
- Does the site have the proper zoning for your business?
- Do you need an existing building or new construction?
- What are the total project costs, including land, taxes, and incentives?

- Does the property's availability and readiness affect your timeline?
- What is the current road access and planned municipal improvements?
- Do you need rail to move products or feedstock and supplies?
- What is the proximity to a rail line? Is a rail spur needed?
- What are the environmental concerns?
- What are the major barriers to making the site viable?

Phase D: Incentive Negotiations and Final Selection. At this stage, the incentive negotiations with local and state governments begin in earnest. Because of the long-term consequences of the company's ultimate decisions, the company may also wish to conduct second visits to finalist locations to gain a greater understanding of the local communities and their respective attributes. The key to obtaining the right level of incentives is a structured process working with a consultant to approach and interact with economic development professionals. Experience with site selection for complex industrial projects is essential to be sure no significant factors have been missed. A few of the various caveats to keep in mind are as follows:

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

After additional negotiations, a decision is confidentially made known to the state and local government finalists. Note that, once a company has publicly announced a decision to locate in a specific community or state, or has entered into a binding property acquisition or building lease contract, the company's ability to initiate discussions or further negotiate incentives is greatly diminished and in some jurisdictions forfeited. This stage is accompanied by submitting pertinent documentation and by drafting and reviewing incentives agreements between the company and the particular governmental entity. Depending on the jurisdiction and the public nature of the granting organization, there can be multiple steps in the formal approval process that may take up to several months. Finally, the company issues a joint press release with state and local officials announcing to the public its decision to locate in their community.

III. Real Estate Legal Documents

Along with the final site selection, there will be a concurrent legal negotiation of the real estate purchase and sale agreement or lease and other related legal documents. It is imperative that the company be represented by experienced real estate legal counsel to assist with this important stage. If these documents are not drafted properly, there are many risks to a company that may jeopardize the property acquisition and success of the project. *See* Chapter 16, *Owning and Leasing Facilities in the United States*, for additional information about owning and leasing real property.

IV. Land and Real Estate Due Diligence

During the inspection period of the purchase agreement, comprehensive due diligence should be conducted on the property to properly evaluate the site or building for project suitability and environmental concerns. An ALTA Survey, title search and commitment, environmental site assessment (Phase I), property condition assessment, cultural survey, geotechnical survey, wetland delineation, and endangered species study are a few of the studies and reports that might be needed. These studies and reports are typically managed and arranged by the consultant. A thorough review of title, survey, and due diligence studies by an experienced environmental and real estate legal team is needed to identify what

improvements must be made, which may include strategic mitigation of identified environmental concerns, additional site preparation efforts, or further due diligence studies. *See* Chapter 18, *Environmental Law*, for additional information about environmental matters.

C. Types of Incentives

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

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

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

D. Cultural Differences in the New Location

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

I. Contracts

In some countries, laws and statutes provide significant background structure and detail for business relationships, so that lengthy contracts covering those items are not absolutely necessary. That is not the case in the United States, where the clear preference is to document business relationships in detailed and precise written agreements, and, as such, written agreements in the United States tend to be longer than in many other countries. This approach has worked well in the United States, since it both permits the parties great flexibility in crafting their agreement and forces the parties to address and resolve the more difficult and potentially divisive issues at the beginning of the relationship. The parties then can concentrate on their core businesses, without distraction from serious, unanticipated issues arising later in the relationship.

Despite protestations from a company's trading partners about the length and complexity of proposed contracts, thorough contracts have long been accepted as the norm in the United States. After complaining about the length or detail of a proposed contract, most trading partners quickly proceed to dealing with the particulars and concluding the agreement. Non-US companies setting up operations in the United States should avoid contracts that lack precision and breadth and should insist that commercial relationships of any significance be clearly and completely documented.

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

II. Community Involvement

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

III. Local HR Executive

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

adjusting to United States and regional customs, is one of the most complicated aspects of establishing a presence in a new country. What motivates employees or improves production output in the home country may have the opposite effect or be illegal in the United States. For example, unlike curriculum vitae used in most parts of the world, American resumes are typically one page in length and do not include photos. Moreover, employers cannot ask potential employees about their age, pregnancy status, marital status, or how many children they have at home. Additional employment law topics are touched on in Chapter 8, *Employment Law (Federal and State*). A good human resources executive can guide the company through the start-up process and serve as a cultural translator. A strong human resources executive can also help the company identify the appropriate vendors, such as professional employer organizations (PEOs), payroll companies, and employee benefit plan brokers, that are best suited to help the company achieve its needs from an administrative perspective.

IV. Legal Environment

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

All companies are subject to two general sets of legal guidelines. The first is statutory law, consisting of various statutes, laws, and ordinances enacted by elected legislative bodies (the US Congress, state legislatures, local municipal governments, etc.). The other is known as common law, which is a body of law that has developed from court cases in the United States.

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

V. Statutory Law

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

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

States, and the cities, towns, and special districts within each state, have the authority to enact laws affecting intrastate commerce (i.e., commerce within the state or applicable jurisdiction). An example of a matter reserved to each state is regulation of the formation and operation of business entities. Corporations, limited liability companies, and other business entities are, almost without exception, not formed under federal law. Those entities are products of state law, with each state having its own set of

laws governing the formation and operation of business entities within that state. Companies often consider forming their business entities in Delaware because of that state's long and developed history of corporation statutes, as well as its court systems' experience with and efficiency in deciding matters of business law.

VI. Agency Rules and Regulations

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

Similar to the federal government, each state government has regulatory agencies that interpret and implement laws enacted by that state's legislature. Those laws are intended to complement or supplement federal statutory laws and may address issues specific to the particular state.

Actions of regulatory agencies (federal and state) typically can be challenged administratively, and in court, if they are unconstitutional or inconsistent with the general principles prescribed by the legislative bodies.

VII. Common Law

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

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

VIII. Court Systems

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

In the federal judicial system, the Supreme Court of the United States is the ultimate arbiter of federal law issues, but the vast majority of federal cases are resolved at lower levels of the federal court system. The entry level courts in the federal system are the US District Courts. Appeals from decisions of those courts are made to regional US Courts of Appeal, with ultimate appeal to the US Supreme Court. Note that the US Supreme Court does not have to accept an appeal, and most appeals to it, in fact, are not accepted. There are also several specialty courts in the federal system designed to deal with specific types of cases (e.g., the US Tax Court for federal tax matters and the Federal Circuit Court of Appeals for appeals of certain patent and international trade cases).

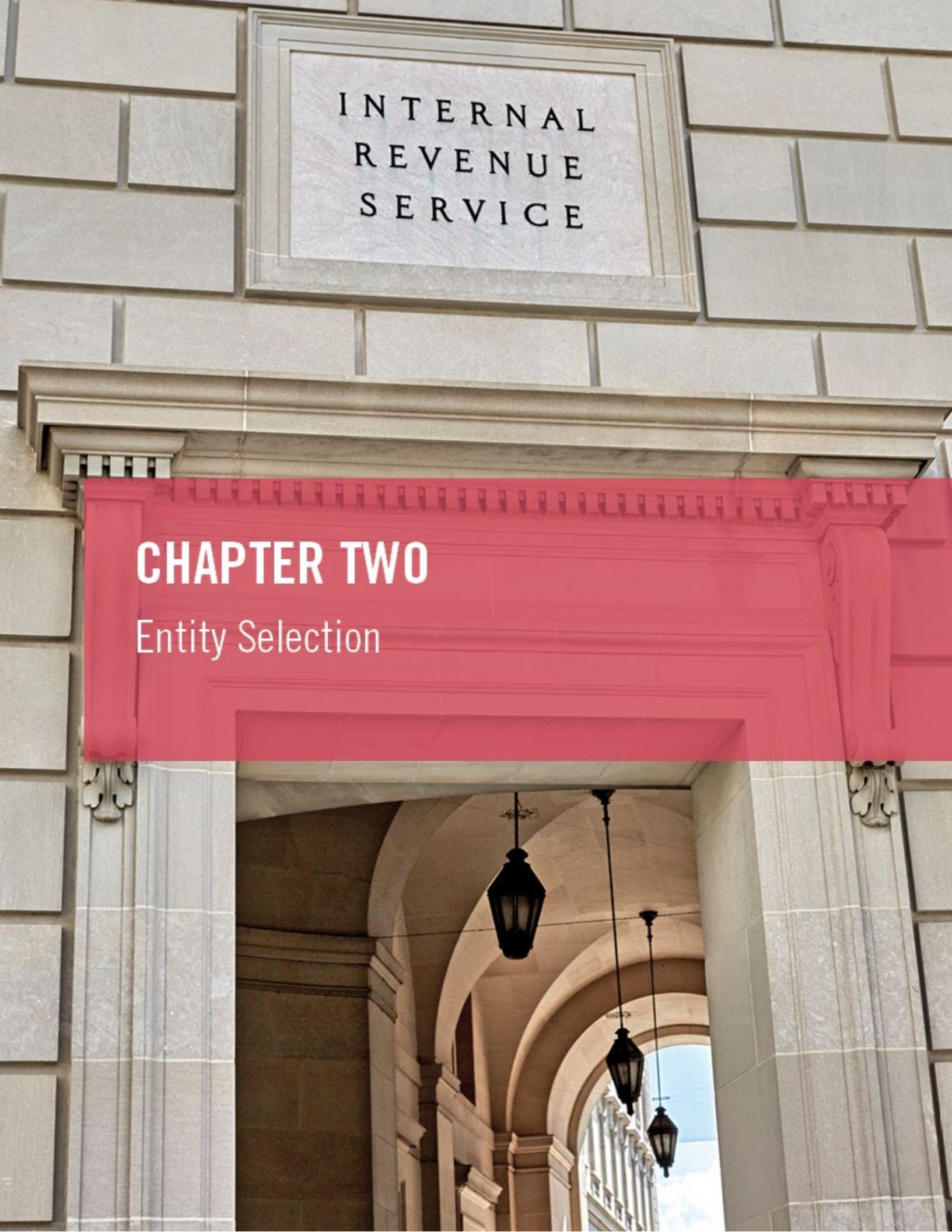
State courts are fashioned, in most cases, on the federal model. Lower courts serve as intake courts for most cases, with an appellate court level above the trial court and a state supreme court sitting as the final arbiter of disputes. Depending on the type of action and amount in controversy, initial entry into a state court system is through a lower court (typically housed in each county). Appeals from those courts are to the state's court of appeals, with final appeals being made to that state's supreme court. Under some circumstances, decisions of a state supreme court can be appealed through the federal judicial system. Note that not all states use the same nomenclature to specify their three levels of jurisdiction. In New York State, for example, the highest court in the system is known as the Court of Appeals, and the intermediary appellate courts are called the Appellate Divisions of the Supreme Court.

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

IX. Arbitration and Litigation

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

Because litigation in the court systems of the United States can be very time consuming and expensive, the trend in the United States has been toward favoring alternative dispute resolution procedures (mediation and arbitration). Those processes are described more fully in Chapter 10, *Supplier and Customer Contracts*. Before full-scale litigation is permitted to proceed, many states require that parties participate in mediation efforts to determine whether common ground for settlement can be found.



CHAPTER TWO

Entity Selection

Chapter Two -

ENTITY SELECTION

One of the most important decisions to be made by a non-US company establishing business operations in the United States is determining what type of business entity in which to operate. That decision is complex, involving factors unique to each circumstance and requiring analysis of the considerations covered generally in this chapter but supplemented by Chapter 3, *Corporation Formation and Operation*; Chapter 4, *Limited Liability Company Formation and Operation*; Chapter 5, *Taxation of United States Operations*; and Chapter 12, *United States Joint Ventures*.

A. Branches and Divisions

If a non-US company operates directly in the United States, it usually does so through an internal branch or division. A branch or division has no separate legal entity status in and of itself. It is merely a part of the company. Operating in the United States through a branch or division may save a non-US company the time and expense of establishing and maintaining a separate subsidiary, but it can also create practical challenges such as opening bank accounts and compliance with US employment and other laws and regulations.

Further, operating a US branch or division means that there is no intervening entity between the company and third parties dealing with its US operations. Because of the potential liability exposure and significant tax complexities encountered when operating through a US branch or division, many non-US companies avoid direct operations in the United States, absent special circumstances (*see* Chapter 5, *Taxation of United States Operations*). If a non-US company does operate in the United States directly, it should try to limit its contractual and product liability exposure and obtain adequate insurance to protect against those potential liabilities.

B. Subsidiary Corporations

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

Although it may be owned by a non-US company, a US subsidiary corporation is domiciled (for tax purposes) in the United States and is subject, generally, to the same income tax rules under the Internal Revenue Code as other US corporations. Consequently, all of the subsidiary's worldwide income is subject to tax in the United States. However, special rules apply to distributions to the parent company. Those rules and related issues are discussed in Chapter 5, *Taxation of United States Operations.*

C. Partnerships

If a non-US company operates through a general partnership in the United States, the results (for liability and tax purposes) will be comparable to operations through a branch or division. For that reason, use of a general partnership, with a non-US company as a direct general partner, is typically avoided. General

partners are responsible, without limit, for any liabilities incurred by the partnership, and they will be subject to tax in the United States on their allocable share of income of the general partnership. The liability exposure of a general partner can be mitigated, to some degree, if the general partner is itself a corporation (or another entity carrying a liability shield) with limited assets. If it is necessary to use a general partnership, it is sometimes advisable to create a single-purpose limited liability company or corporation for purposes of owning the general partnership interest. That structure provides a liability shield between creditors of the general partnership and the ultimate owner (assuming the integrity and effectiveness of that single purpose entity).

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

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

D. Limited Liability Companies

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

As described in Chapter 5, *Taxation of United States Operations*, general partnerships, limited partnerships, and limited liability companies (by default) are taxed in the United States under the partnership taxation scheme. Income from the operations of those entities flows through to the owners of the business (the partners of a partnership and the members of a limited liability company). Those owners file tax returns and report and pay tax on that income.

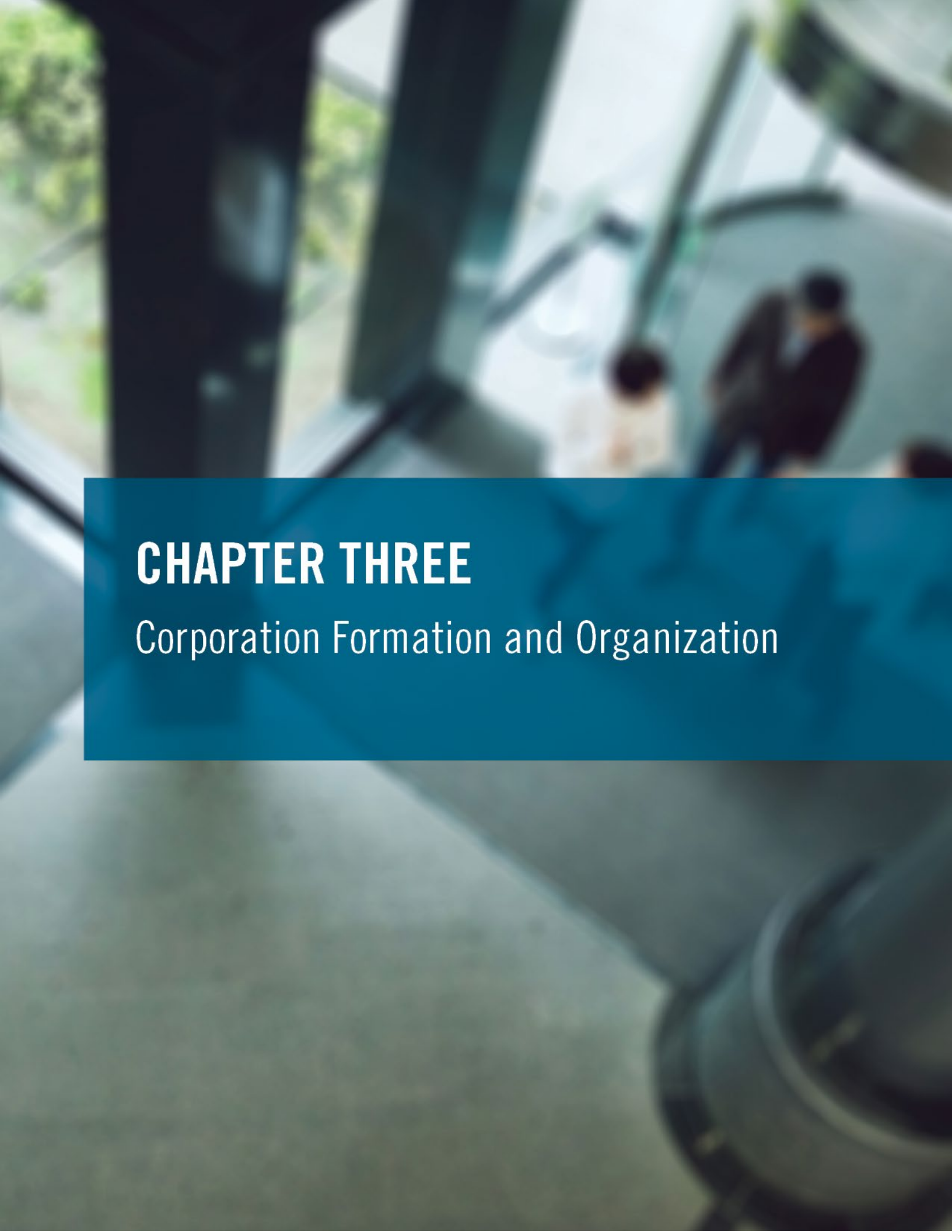
While limited liability companies and partnerships are taxed in the same way, the liability of their respective owners for debts and obligations of the business differ significantly. As noted above, general partners in a general partnership and a limited partnership are liable, without limit, for activities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

One of the drawbacks of limited liability companies is that they are generally not eligible in the United States to participate in tax-free reorganizations because the reorganization provisions of the Internal Revenue Code apply only to entities taxed as corporations. Consequently, the ability to dispose of an interest in a limited liability company through a tax-deferred exchange for stock of a publicly traded company may be limited. As described in Chapter 5, *Taxation of United States Operations*, some entities

can elect their classification for US tax purposes, but such elections should only be undertaken based on specific tax advice.

E. Securities Laws

As discussed in more detail in Chapter 6, *Regulation of Non-US Companies*, stock and certain interests in limited liability companies and limited partnerships are securities. The offer and sale of securities is governed by various restrictions and registration requirements imposed by federal and state laws, which are intended to safeguard the investing public. To the extent that an ownership interest constitutes a security, it should only be issued pursuant to an exemption from the registration requirements or, in the absence of an exemption, pursuant to a registration statement filed with applicable regulatory agencies.



CHAPTER THREE

Corporation Formation and Organization

Chapter Three -

CORPORATION FORMATION AND ORGANIZATION

A. Formation and Entity Status

Each state in the United States has its own statutes authorizing the formation of business entities such as corporations and limited liability companies. A business entity formed pursuant to a state's statutes is subject to that state's laws, as well as to applicable federal laws and the laws of other states where that entity does business. This chapter discusses the formation and organization of corporations. The following chapter deals with limited liability companies, although, as noted in both chapters, some of the concepts addressed in this chapter are equally applicable to limited liability companies. Attached to the end of this guidebook as **Attachment 1** is a flow chart indicating the steps in the process of forming a corporation or limited liability company.

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

I. Corporate Name

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

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

Also, other persons may have made name protection filings with the Federal Patent and Trademark Office that may significantly limit or eliminate any rights that the new corporation may have with respect to its name or any confusingly similar name (*see* Chapter 14, *Protection of Intellectual Property*). Again, the fact that a state permits a filing of a particular name does not, by itself, create irrefutable rights in that name. Those rights are determined under state and federal law governing trade name usage.

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

Non-US companies and their US subsidiaries, in their own right, should take advantage of the protections afforded other businesses in the United States by making federal and state filings to protect their distinctive names, logos, and slogans. Those filings can be important in preventing other businesses from pirating, or infringing on, those valuable assets. *See* Chapter 14, *Protection of Intellectual Property*, for additional information about that process.

II. State Formation Filings

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

Statutory business entities such as corporations and limited liability companies do not come into existence until the formation documents (e.g., the Articles of Incorporation in the case of a corporation) are filed with the appropriate governmental agency of the state of formation. Consequently, if a corporation or limited liability company will be the vehicle through which a non-US company will do business in the United States, it is important that state filings be completed as soon as practicable once the decision to operate in the United States has been made. The non-US parent company should avoid significant preliminary activity in the United States in its own name if it desires to avoid direct liability for those actions and the possible creation of a permanent establishment for US taxation purposes (*see* Chapter 5, *Taxation of United States Operations*).

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

- Name of the corporation;
- Number of shares of stock that the corporation is authorized to issue;
- Name of the registered agent and address of the registered office of the corporation in the state of formation; and
- Name and address of the incorporator.

The Articles of Incorporation may include additional provisions that are deemed advisable or are required in the particular circumstances, and many state laws require that certain provisions be expressly set forth in the Articles of Incorporation. For instance, many corporations provide in their Articles of Incorporation that members of the board of directors will have no personal liability for monetary damages for actions taken by them in that capacity subject to any limitations imposed by statute. If the corporation is to have separate classes or series of stock, if special voting rights will be applicable to holders of certain classes or series of stock, or if stockholders will have rights to purchase additional stock in new issuances (often referred to as preemptive rights or rights of first offer), those provisions should be set forth in the Articles of Incorporation.

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

It is permissible (but not required in most cases) for the names of the initial members of the board of directors to appear in the Articles of Incorporation, but for privacy purposes, the names of initial directors

typically are not set forth in the Articles of Incorporation. The initial directors instead are named in the organizational documents for the entity (discussed below), which are not filed with the state and generally are not available to the public. However, some states require that annual reports listing current officers and directors be filed with the Secretary of State. Those filings typically are available to the public.

While most filings are made with the office of the Secretary of State of the particular state, filings also may be required with the Department of Revenue of the state. Further, various filings also may be required with the local governments where the business will operate (city, county, etc.). If the business entity will be using a trade name that differs from its legal name, as reflected in the Articles of Incorporation, a Certificate of Assumed Name (or comparable document) may need to be filed in the local Register of Deeds or with the Secretary of State. This puts the public on notice that the business entity is operating under a trade name that is different from the name in the Articles of Incorporation.

III. Registered Agent and Office

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

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

IV. Importance of Maintaining Entity Status

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

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

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

While, as a general matter, the financial exposure of owners of a US business entity will be limited to the investment made by those owners in that entity, additional exposure may be incurred if the owner voluntarily consents to that exposure. For instance, a supplier or landlord of a business may refuse to

deal with the US business entity without a guaranty from the owner. Such guaranties, if enforced directly against the owners, may result in liabilities significantly greater than the amount invested in the US business entity. Guaranties should be carefully considered and documented.

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

B. Organization

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

I. Initial Action of Incorporator and Board of Directors

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

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

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

The initial actions of the board of directors typically include the following:

- Ratifying and confirming the actions of the incorporator;
- Confirming the bylaws adopted by the incorporator;
- Electing officers of the corporation;
- Approving the initial issuance of stock to the subscribing stockholders;
- Authorizing the opening of bank and brokerage accounts;
- Authorizing significant contracts (leases, bank loans, employment agreements, major contracts, etc.); and
- Any other matters that require authorization or approval of the board of directors.

II. Issuance of Stock

Pursuant to authorization from the board of directors, stock of the corporation is issued to each of the subscribing stockholders upon receipt of the consideration recited in a subscription agreement. It is important that the consideration (cash, property, etc.) actually be transferred to the US entity so that the stock issuance can be properly effected. Subject to compliance with applicable state statutes, the stock

issued to the owners can be evidenced by either (i) a physical stock certificate, or (ii) through an electronic book entry system maintained by the corporation without the need for a physical stock certificate.

III. Debt vs. Equity

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

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

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

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

C. Stockholders, Directors, and Officers

The stockholders of a corporation exercise control over the corporation by electing the members of the board of directors. The board of directors, in turn, manages (or directs the management) of the business and affairs of the corporation and, in that capacity, oversees the operations of the corporation and sets policies and procedures, pursuant to which the officers of the corporation conduct the corporation's day-to-day business.

Unless the governance documents of the corporation provide otherwise, action by stockholders or the board of directors generally can be taken by majority vote at a properly called meeting at which a quorum exists. A quorum typically requires the presence, at a properly called meeting, of more than half of the voting power held by the corporation's stockholders or members of the board of directors (as applicable). Stockholder and board of director action can also be taken by written consent (without a formally called meeting) if done in compliance with applicable state statutes and the Articles of Incorporation and bylaws

of the corporation. Unlike many other jurisdictions, in the United States, a director generally cannot provide another person such director's proxy or have an alternate at board of directors meetings.

Officers carry out the day-to-day business of the corporation and serve for terms, and on such other conditions, as are determined by the board of directors or established by the bylaws of the corporation. Officers typically consist of a president, a treasurer, and a secretary. Other positions and titles are also used as circumstances require (for example, chief executive officer, chief operating officer, vice presidents, assistant secretaries, etc.).

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

Stockholders, directors, and officers need not be residents of the state of incorporation or of the United States. Foreign nationals residing outside of the United States can fill those positions. It usually is helpful, however, to have an individual with delegated authority physically present in the United States for purposes of facilitating transactions that occur in the ordinary course of business. Further, foreign nationals holding those positions should make sure that their activities in those capacities do not violate US immigration laws or unintentionally subject them to US taxation (*see* Chapter 9, *Immigration Law*).

D. Bylaws and Governance Documents

The bylaws of a corporation set forth the general governance procedures of the corporation. They prescribe methods for calling both stockholders and board of directors meetings, as well as the methodology for casting votes at those meetings and the requisite votes necessary to take particular actions. The bylaws typically cover, among other things, the following items:

- Quorum and voting standards for the conduct of business at stockholders and directors meetings;
- Authorization of action without a meeting (by written consent) if the appropriate number of signatures are obtained;
- Number, term, qualification, election, and removal of directors;
- Authorization of various committees of the board of directors or the method by which such committees may be established;
- Manner and time frame for giving notice of meetings of stockholders and directors;
- Participation at board meetings by conference telephone;
- Titles of the various officers of the corporation and details as to their specific roles;
- Process for appointing and removing officers;
- Authorizations and restrictions on entering into contracts and loans;
- Format for issuance and transfer of stock by either physical stock certificate or electronic book entry;
- Records and financial statements required to be maintained (if any); and
- Provisions indemnifying officers and directors for expenses and other liability incurred in carrying out their duties, if appropriate.

In addition to the bylaws, it is sometimes advisable for the stockholders to enter into an agreement governing their rights as stockholders. Such an agreement is not necessary when a corporation is owned solely by one entity or individual, but if stock is issued to several stockholders, the stockholders may wish to execute an agreement imposing transfer restrictions and addressing one or more of the following issues:

- Requiring that stockholders offer to sell stock back to the corporation or to the other stockholders first, before offering that stock for sale to a third party, at the same price as offered by the third party (often referred to as a right of first refusal);
- Preventing stockholders from making any transfer of stock (including by sale, assignment, pledge, gift, or other disposition) without the consent of the board of directors or the other stockholders;
- Obligating employee stockholders to sell to the corporation (or giving the corporation the option to purchase) their stock upon termination of their employment, death, or other triggering event; and
- Determining the price to be paid for stock purchased on specified triggering events.

On the other hand or additionally, the stockholders may want such an agreement to require stockholders to vote as provided in such agreement, or as determined in accordance with a procedure set forth in such agreement, with respect to certain matters, such as the election of directors, including any directors nominated by certain stockholders, and fundamental activities of the corporation, such as liquidation, significant acquisitions, and amending the Articles of Incorporation and the bylaws.

E. Taxpayer Identification Number

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

CHAPTER FOUR

Limited Liability Company Formation and Operation

Chapter Four -

LIMITED LIABILITY COMPANY FORMATION AND OPERATION

A. Formation and Entity Status

As is the case with corporations, each state in the United States has its own statutes authorizing the formation (and providing liability insulation for the owners) of limited liability companies. Considerations with respect to the appropriate state in which to form a business entity, name usage, the importance of maintaining entity status, and the other common principles referenced in Chapter 3, *Corporation Formation and Operation,* are equally applicable in the context of formation and operation of limited liability companies. From that point, however, the analysis of limited liability companies and corporations begins to diverge, due to the fact that one of the significant benefits of limited liability companies, relative to corporations, is the greater flexibility they offer in structure and operation. Tax considerations are also significantly different from those of corporations.

Statutory law plays a more prominent role in the governance and operation of corporations than is the case with limited liability companies. While there are many rights that automatically vest in stockholders of a corporation under state statutes, typically, there are fewer statutory counterparts in the limited liability company context. State statutes give wider latitude to the owners (members) with respect to the economic and governance arrangements of a limited liability company. Those arrangements are set out in a document, negotiated by the members, typically known as an Operating Agreement or (such as in Delaware) a Limited Liability Company Agreement (in either case, referred to hereafter as the Operating Agreement)

The balance of this chapter discusses the mechanics of forming and operating a limited liability company. A flow chart of this limited liability company formation process is attached to the end of this guidebook as **Attachment 1.**

I. Entity Name

Just like corporations, limited liability companies must clearly identify themselves to the public as that form of business entity. For instance, Delaware law requires that a limited liability company have in its name one of the following designations:

- Limited Liability Company;
- L.L.C.; or
- LLC.

Limited liability company name usage and rights to use a name are subject to the same considerations as are discussed in detail with respect to corporate names in Chapter 3, *Corporation Formation and Operation*.

II. State Formation Filings

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

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

- Name of the limited liability company;
- Name and address of the registered agent and registered office for the limited liability company;
- If the existence of the limited liability company is not to be perpetual, the date on which it is to dissolve;
- Name and address of the person signing the Articles and whether that person is acting as the organizer or other authorized person or as a member (an owner of the limited liability company);
- If the members are not to be the managers of the limited liability company, a statement to that effect; and
- Any other provision appropriate for the particular limited liability company.

Managers of a limited liability company are the persons who managed the business and affairs of the limited liability company, all within the parameters set out in the Operating Agreement. The members of a limited liability company are presumed by statute to be the managers of the limited liability company, unless the members (i) delegate that function to others (in the Operating Agreement), or (ii) vest that function in managers (by including a provision to that effect in either or both the Articles and the Operating Agreement, as appropriate under applicable state statutes). The latter approach creates what is called a manager managed limited liability company and, to the extent included in the Articles and depending on the particular state's statute, can serve to put the public on notice that the members, as a general matter, may not contract on behalf of the limited liability company and that operational matters require the involvement of the managers.

The managers (whether provided for in the Articles or in the Operating Agreement) need not be members, and, as noted above, members need not be managers. Managers may delegate their authority and duties to others and may appoint officers with titles similar to those used in the corporate context (e.g., president, treasurer, chief operating officer, etc.), if that helps to clarify their role for third parties. Foreign nationals, whether or not residents of the United States, can hold positions as members, managers, or officers, although holding an ownership interest in a limited liability company with U.S. operations may subject the foreign national to US income taxation.

It is important to note that in some states, such as Delaware, a limited liability company is not fully formed until it both has filed its Articles with the applicable office of the Secretary of State and has an Operating Agreement (with at least one member). Some states, such as Delaware, permit the Operating Agreement to be written, oral or even implied, although a written Operating Agreement is generally advisable, and allow such Operating Agreement to be made effective as of the filing of the Articles with the Secretary of State. Care should be taken to ensure that a limited liability company is fully formed before operating or there could be potential authority and liability protection concerns.

III. Registered Agent and Office

Similar to a corporation, the registered agent of a limited liability company must reside or maintain an office (which will be the limited liability company's registered office) in the state in which the limited liability company is formed. The primary duty of the registered agent is to receive, on behalf of the limited liability company, any legal notices, judicial process, or similar legal demands directed to the limited liability company.

IV. Importance of Maintaining Entity Status

Limited liability companies provide the same liability protection to their members as corporations do for their stockholders. Consequently, it is very important that the entity status of the limited liability company be maintained. In that regard, limited liability companies should follow similar good housekeeping practices as are set out for corporations in Section A.IV. of Chapter 3, *Corporation Formation and Operation*.

B. Members and Managers

A member of a limited liability company becomes one either by being named as a member in the Articles (if the applicable state statute so provides) or by being admitted as a member through the Operating Agreement. Additional members may be admitted, from time to time, following the initial organization in accordance with procedures set forth in the Operating Agreement. Members can be individuals or other business entities and, as noted above, need not be residents or citizens of the United States. A limited liability company can have as few as one member (a single member LLC) or as many as desired, subject to the securities law restrictions referenced in Chapter 6, *Regulation of Non-U.S. Companies*.

The members are the owners of the equity interests in the limited liability company, and the rights, duties, and obligations of that status are typically set forth in an Operating Agreement (including the voting rights of various members) in order to modify or confirm those that would otherwise apply under the applicable state statute. Certificates or other evidence of ownership typically are not issued by limited liability companies, unlike corporations that issue shares of stock, but are permissible if so provided in (or not prohibited by) the Operating Agreement.

C. Operating Agreement

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

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

The following are provisions typically found in an Operating Agreement:

I. Scope of the Company's Business

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

II. Initial and Additional Capital Contributions

Operating Agreements often contain a schedule listing the capital contributions that each member has made, or will make, to the limited liability company. Those contributions can be in cash or in the form of tangible or intangible property, as agreed by the members. For a limited liability company treated as a partnership for income tax purposes, such contributions serve as the starting point for each member's capital account to be taken into account when considering relative rights to operating and liquidating distributions. It is important that the members determine the likely future capital requirements of the business and obtain commitments from the members to fund those requirements. In many cases, however, the members may not want to commit themselves to further capital contributions, and this is an important understanding to have reflected in the Operating Agreement. The provisions of the Operating Agreement addressing capital contributions typically outline the procedure for additional capital calls from the members, if any, as well as the consequences of a member failing to comply with a capital call. Capital calls can be made in any number of ways, including by a majority vote of the members, by the managers or pursuant to a schedule of capital commitments. As is the case with most aspects of limited liability company operations, the members are free to design and reflect in the Operating Agreement any procedures that fit their needs.

III. Management

Whether management of the limited liability company is carried out by the members or by one or more appointed managers, actions typically are authorized by a majority vote of the appropriate group. Of course, circumstances may require variations, and the Operating Agreement can specify any process or other voting percentage desired by the members, including voting or consent requirements only applicable to certain individual members or managers or to specified classes or groups of members or managers. For instance, certain actions may be so fundamental to the relationship of the parties that a unanimous or supermajority vote of the members or managers (or specified classes or groups of members or managers) might be required. Actions that might fall into that category include issuance of additional interests, admission of new members, subjecting the members to personal liability or additional capital contribution obligations, placing the limited liability company into bankruptcy, incurring significant debt, dissolving the limited liability company, selling substantially all of the limited liability company's assets, and other similarly significant matters.

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

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

IV. Fiduciary Duties, Exculpation, and Indemnification

Unless specifically modified by the Operating Agreement, the members, managers, and officers of a limited liability company may have certain fiduciary duties to the limited liability company or to its members by default under applicable state law. Often such default duties will include a duty of care and a duty of loyalty similar to those required of stockholders, directors, and officers of a corporation. However, applicable state law often permits members in an Operating Agreement to define those duties, including expanding, restricting, or in certain states even eliminating any such duties. Operating Agreements,

therefore, often specify the standards of care and other duties that the members intend to apply with respect to the members, managers, and officers, including whether or not certain business opportunities that may present themselves to a member, manager, or officer must first be offered to the limited liability company before the member, manager, or officer can pursue or engage in that activity outside of the limited liability company.

In addition, the Operating Agreement usually will provide for exculpation from liability of the members, managers, and officers to the limited liability company and its members, unless they fail to meet certain specified standards of care or act in a manner that the Operating Agreement specifies will not protect them from liability (e.g., gross negligence, willful misconduct, fraud, etc.). Similarly, the Operating Agreement will typically provide for mandatory indemnification by the limited liability company for losses incurred by the members, managers, or officers in defending legal actions or similar proceedings against them relating to their acting in such capacity on behalf of the limited liability company, including advancement of legal fees prior to final disposition, assuming such actions did not violate the same standards as set forth in the Operating Agreement for their exculpation.

V. Allocation of Profits and Losses

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

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

As set forth in Chapter 5, *Taxation of United States Operations*, a limited liability company treated as a partnership generally reports to federal and state taxing authorities the members' respective net profit or loss allocation. The members then include that allocation on their own individual income tax returns. A single member LLC is generally treated as a branch of its owner for income tax purposes. As a result, a limited liability company itself generally pays no U.S. federal income tax (although a few states impose income taxes on limited liability companies in a fashion comparable to corporations). Limited liability companies are, in some instances, able to elect to be treated as corporations for federal income tax purposes, which should only be considered with guidance from a knowledgeable and experienced tax advisor.

VI. Distributions

The flexibility of limited liability companies permits the members to agree in the Operating Agreement on how distributions of cash and property are to be made by the limited liability company. Again, distributions need not be made in the same manner as net profit and loss allocations are made and need not be based on capital account balances, ownership interests or voting rights. Consequently, arrangements can be made, for instance, to distribute funds first to those members that have contributed cash or other valuable assets to the limited liability company (as opposed to those contributing just services) in order for those

money members to receive back their initial investments before subsequent available cash is shared among all of the members.

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

VII. Transfer Restrictions and Buy/Sell Provisions

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

As is the case with corporations, the members holding a majority interest in a limited liability company may want to impose restrictions on members holding minority interests (or who have received their interests for services). A typical provision would impose on those members an obligation to offer first to sell their interests back to the limited liability company or to the majority members, before offering the interests to others, and to require that their interests be sold in that manner upon termination of employment or other comparable event. These same issues arise in the corporate context and are discussed in Chapter 3, *Corporation Formation and Operation*.

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

VIII. Amendments

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

D. Taxpayer Identification Number

Each limited liability company (other than a single member LLC) is required to obtain from the Internal Revenue Service a taxpayer identification number. A single member LLC may be required to obtain its own taxpayer identification number if it will have employees. Further, while the limited liability company is typically not a taxpayer itself (passing through all items of income and loss to its members), a multi-member limited liability company is generally required to file tax returns showing the net income and loss generated by the enterprise and how that net income and loss has been allocated to the members. A limited liability company that has elected to be treated as a corporation for income tax purposes may have additional obligations, and such elections should only be considered with guidance from a knowledgeable and experienced tax advisor.

CHAPTER FIVE

Taxation of United States Operations

Chapter Five -

TAXATION OF UNITED STATES OPERATIONS

A. Introduction

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

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

While there are many exceptions, the US federal taxation scheme is intended to be economically neutral (so as to not favor one type of company over another) and to create a level playing field, where all participants are subject to the same general taxation burden. This enhances competition and strengthens the US economy. However, achieving that laudable goal requires significant complexity.

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

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

B. Effect of Tax Treaties

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

The Internal Revenue Service is well aware that certain treaties with the United States are more favorable than others. Consequently, the United States has instituted various treaty shopping restrictions to discourage elaborate arrangements that direct income through countries with the most favorable treaties (even though those countries have little or no direct involvement with the transaction). Such schemes defeat the general fairness of the treaty system. One example of such restrictions is the limitation on benefits provision included in most US tax treaties that limit the application of a treaty to qualifying residents.

C. United States Subsidiary Operations

I. Taxation of Corporate Subsidiaries

In many situations, foreign companies find that it is less complicated and more cost efficient (and presents less liability exposure) to operate in the United States through a subsidiary corporation, rather than directly through a branch or division (*see* Chapter 2, *Entity Selection*). While the subsidiary corporation will likely be required to report information about its beneficial owners to the US Financial Crimes Enforcement Network (FinCEN), the reporting obligation is not significant (for more information regarding this law designed to combat money laundering and other illicit activities, *see* Chapter 6, *Regulation of Non-US Companies,* Section H, *Corporate Transparency Act*).In keeping with general rules applicable to all corporations formed in the United States, the subsidiary's income, no matter where earned (inside or outside of the United States), generally will fall within the US taxing jurisdiction as a result of the subsidiary being organized in the United States. Repatriation of earnings of the subsidiary to the non-US parent company, as well, will be subject to US withholding tax rules, as discussed below.

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

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

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

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

II. Transfers of Appreciated Assets

A foreign company must plan carefully if it intends to transfer appreciated assets to its US subsidiary. When properly structured, those transfers can be accomplished without immediate tax consequence.

However, there may be implications for the foreign company in its home country with respect to such a transfer. It is also possible that **all** appreciation in the assets (including appreciation that occurred prior to the transfer to the US subsidiary) may be taxed in the United States if those assets are subsequently disposed of by the subsidiary. That can be the case, as well, when assets are transferred to a branch or division of the foreign company in the United States.

III. Taxation of Dividend and Interest Payments to Foreign Parent

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

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

IV. Intercompany Loans

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

Assuming that the other terms and conditions of an advance are sufficient to support debt characterization, the loan must carry a market interest rate. The Internal Revenue Service publishes a series of applicable federal rates (adjusted monthly based on market conditions) that serve as guidelines for determining whether the interest rate on indebtedness between affiliated companies is comparable to the terms that would be offered by independent third-party lenders. If an interest rate is too low or is not paid, the Internal Revenue Service can impute a higher interest rate. Even if a chosen interest rate is appropriate, recently implemented rules limit the deductibility of interest based on a percentage of the earnings of the borrower.

In addition to these general rules, certain intercompany debt instruments are automatically recharacterized as equity in the issuer if issued to certain related parties (i) in a distribution, (ii) in exchange for related-party stock, or (iii) in exchange for property in certain asset reorganizations. These rules also recharacterize as equity any debt instrument issued to certain related parties in exchange for money or property to fund such a transaction. An expansive rule treats a debt instrument issued during the period beginning 36 months before and ending 36 months after a covered transaction as funding the related transaction. These rules have been subject to numerous changes, and the Internal Revenue Service continues to study how they may be further modified.

D. Direct Operations in the United States

I. If No Applicable Tax Treaty

If a non-US company operates directly in the United States (through a branch or division in the United States, which can result from personnel located in the United States) rather than through a corporate

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

II. If a Tax Treaty is in Effect

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

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

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

If a non-US company has a permanent establishment in the United States, it will be taxed on its income attributable to that permanent establishment. Analysis of income attributable to those US operations is somewhat different than determining effectively connected income in the non-treaty context, but generally less expansive.

III. Entity Classification

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

IV. Branch Profits Tax

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

As noted above, the US tax system seeks to create rough equality between various methods of conducting business in the United States, so that one method is not preferred, artificially, over another. In keeping with that principle, the branch profits tax imposes a surcharge on the earnings and profits

generated by the US operation of a non-US company in an amount comparable to the withholding tax that would have been imposed on dividends repatriated by a US corporate subsidiary to its non-US parent company.

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

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

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

E. Transfer Pricing Regulations

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

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

Transfer pricing restrictions can be inflexible and in some cases can produce inequitable consequences. Consequently, careful planning, analysis, and documentation are required to anticipate and deal properly with the transfer pricing rules. Advance planning can significantly reduce the expense and aggravation of dealing with an Internal Revenue Service audit of transfer pricing issues and possible increased tax liability. Recent international action to combat tax avoidance through base erosion or profit shifting, particularly with respect to the ownership and exploitation of intellectual property, has made transfer pricing considerations increasingly important.

F. State and Local Taxation

Most states and some local jurisdictions impose their own income or other business taxes on enterprises conducting business within or making sales into their jurisdictions. Businesses with permanent physical operations in a state will almost certainly have some business tax liability in such state; however, even businesses without a physical presence in a state may become subject to that state's taxing jurisdiction either because of activities they conduct in the state or because their sales of products or services into the state exceed a designated minimum threshold. Because some states do not follow federal tax treaties, protections provided at the federal level by a treaty will not necessarily apply to some state

income and business taxes. In many cases, state income or other business taxes are calculated similarly or by reference to the federal income tax. Taxpayers subject to tax in more than one state may generally apportion or allocate their income among the states according to the relative levels of their business in the states; however, because apportionment and allocation rules differ among the states, it is possible for some taxpayers to effectively pay state income or business tax in the aggregate across all states on greater than 100% of their federal income.

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

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

The FIRPTA assures that profits from the sale of ownership of interests in real property located in the United States are taxed in the United States, whether or not the holders of the interests are doing business or have a permanent establishment in the United States. FIRPTA has an extensive reach (covering direct and indirect ownership interests in real property) and an expansive definition of what constitutes a US real property interest. If such an interest is disposed of, tax must be withheld from the proceeds by the purchaser at the closing of the transaction and remitted to the Internal Revenue Service. For additional detail on FIRPTA, *see* Chapter 16, *Owning and Leasing Facilities in the United States*.

H. Foreign Nationals in the United States

If nationals of a non-US country are substantially present in the United States during a calendar year or if they become lawful permanent residents of the United States, those individuals will be considered US residents for federal income tax purposes and will be required to file US tax returns. Subject to certain limited exceptions, if a non-US national is present in the United States on at least 31 days of the current calendar year, the individual will be substantially present in the United States if the sum of the following equals 183 days or more:

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

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

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

I. Partnership and Limited Liability Company Operations

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

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

CHAPTER SIX

Regulation of Non-US Companies

Chapter Six -

REGULATION OF NON-US COMPANIES

A. Laws and Regulations

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

B. International Investment and Trade in Services Survey Act (IISA)

The US Congress enacted IISA to collect information about foreign investment in the United States. Since the survey is designed merely to gather data, it does not regulate foreign investment, and all information collected under the IISA is held in confidence. For further detail concerning the IISA, *see* Chapter 11, *United States Business Acquisitions*.

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

C. Agricultural Foreign Investment Disclosure Act (AFIDA)

In order to determine the extent to which agricultural lands in the United States are being acquired by foreign interests, the US Congress enacted a law known as AFIDA. AFIDA mandates that any foreign person (meaning individual or legal entity) that acquires, transfers, or holds an interest (including both fee and leasehold interests of 10 years or more) in agricultural land (land used for farming, ranching, pasture, forestry, or timber production) report such ownership and transaction to the US Secretary of Agriculture within 90 days after such acquisition or transfer of the interest in agricultural land (or within 90 days of the point at which land becomes agricultural land). AFIDA considers entities formed under the laws of the United States to be foreign persons and subject to the reporting requirements of AFIDA if a significant interest or substantial control in such entity is held by a non-resident alien, foreign government, or an entity formed under the laws of a foreign government (or a collection of any of the foregoing), where a significant interest or substantial control is deemed to exist if 10% or more is held by a single such person, 10% of more is held by a group of such persons acting in concert, or 50% or more is held in the aggregate by a multiple of such persons). Even if the subject land is currently idle (and not used for agricultural purposes), it will still be classified as agricultural land for purposes of AFIDA if the land was used for agricultural purposes at any time in the previous five years. Failing to file (or filing an incomplete, misleading, or false report) can result in civil penalties of up to 25% of the fair market value of the foreign person's interest in the agricultural land. AFIDA does not apply to security interests, contingent future interests (e.g., options), easements or rights of way for purposes unrelated to agricultural production, and

interests solely in subsurface mineral rights. Unlike the IISA, information collected from AFIDA filings is available for public inspection and will be disclosed to the applicable state's Department of Agriculture within six months of filing.

D. Currency and Foreign Transactions Reporting Act (CFTRA)

In order to monitor currency flows in the United States and their effect on the integrity of the US financial system, the US Congress enacted CFTRA (also known as the Bank Secrecy Act). CFTRA is an effort to curb money laundering and other illegal activities. Under CFTRA, the import or export of monetary instruments (including currency, traveler's checks, checks, and money orders) in excess of US$10,000 by any person, including a non-US person, must be reported to US Customs and Border Protection at the time of entry to or departure from the United States. Failure to file can result in civil penalties, in addition to the seizure and forfeiture of monetary instruments in transit. Criminal penalties also apply to willful violators.

E. Hart-Scott-Rodino Antitrust Improvements Act (HSR Act)

The HSR Act requires parties to transactions that meet certain jurisdictional thresholds (the size of transaction and size of person tests) to submit premerger notification filings with the US antitrust authorities – the Federal Trade Commission and the Department of Justice Antitrust Division – unless an exemption applies. The merger review framework under the HSR Act provides the authorities with information regarding the deal and allows them to evaluate reported transaction's impact on competition. For further detail concerning the applicability of the HSR Act, *see* Chapter 11, *United States Business Acquisitions*.

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

Under the Defense Production Act of 1950, as amended by the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), CFIUS has broad jurisdiction to conduct national security reviews of control acquisitions and certain non-control investments (collectively referred to as covered transactions) in US businesses by foreign persons. Covered transactions can occur through many different scenarios, including mergers and acquisitions, takeovers through bankruptcy, joint ventures, membership interest purchases, purchases of shares on a public exchange, loan agreements, and any other transaction or contractual arrangement that could provide effective control over a US business by a foreign person. As a result of FIRRMA enhancements, CFIUS also has jurisdiction to review certain acquisitions and leases of, and concessions involving, real estate that provide defined access and control rights to a foreign person.

For transactions falling under its jurisdiction, CFIUS has significant latitude to consider the national security vulnerability presented by a US business against potential threats posed by the foreign party. Based upon that consideration, CFIUS may prohibit a transaction or require the parties to adopt and implement mitigation procedures to eliminate identified national security risks. A broad spectrum of issues touching on national security may be considered by CFIUS including critical supplies to the US defense industry, critical technologies (e.g., semiconductors and advanced computing), ownership or access to critical infrastructure, collection or maintenance of sensitive person data of US citizens, nexus to emerging and foundational technologies, and physical facilities and property with proximity to sensitive US government assets.

Depending upon certain factors, a covered transaction may be subject to a mandatory advance notice to CFIUS. If a notice is not mandatory, the parties may voluntarily notify CFIUS through a filing and request review and clearance. Importantly, transactions that fall under CFIUS jurisdiction and are not reviewed

and cleared remain subject to jurisdiction and could be reviewed any time thereafter, even years in the future. Counsel should be sought regarding the requirement or advisability of making a filing to CFIUS. For further detail concerning the applicability of CFIUS, *see* Chapter 11, *United States Business Acquisitions*.

G. Foreign Agents Registration Act (FARA)

FARA was enacted by the US Congress in order to gather information concerning the activities of foreign interests seeking to influence US public opinion, policy, or laws. FARA requires that agents engaged in certain political, public relations, solicitation, or representation activities on behalf of foreign principals must file a registration statement with the United States attorney general within 10 days of agreeing to become an agent and before performing any activities for the foreign principal. Agents engaged in lobbying activities are specifically exempted from FARA but must register under the Lobbying Disclosure Act. Some exceptions are made in the cases of diplomatic or consular officers (or their staff members), officials of foreign governments, and persons engaging in private, religious, scholastic, scientific, and other nonpolitical activities. All informational materials disseminated by agents who are required to file a registration statement must be conspicuously labeled to indicate that they are distributed by the agent on behalf of the foreign principal and must be filed with the United States attorney general within 48 hours of such materials' transmittal (which filings are made available for public inspection). Failure to comply with FARA can result in criminal penalties.

H. Corporate Transparency Act (CTA)

The CTA was enacted by the US Congress with the stated purpose of combatting money laundering and the engagement of other illicit activities through anonymously owned entities in the United States. The CTA, together with the implementing regulations adopted by the Financial Crimes Enforcement Network (FinCEN), a bureau of the US Department of the Treasury, as originally enacted, would have required that certain US entities and non-US entities registering to doing business in the US make a confidential filing with FinCEN, disclosing, among other things, certain information about its beneficial owners – meaning certain direct and indirect owners and other controlling persons of such entity.

In March 2025, however, FinCEN released an interim final rule (IFR) with respect to the CTA. Under the IFR, all US entities (including those that are beneficially owned or controlled by non-US individuals or entities), as well as any US residents that would have otherwise been reportable (including those that have ownership or control of a non-US entity), are exempt from the reporting requirements of the CTA and no filing is required to be made with FinCEN with respect to such US entities or US residents. Following the latest IFR, the CTA continues to mandate that all applicable non-US entities registering to do business in the United States by filing with a US state must also report their applicable non-US resident beneficial owners through a filing with FinCEN.

It is important to note that the CTA is a constantly evolving statute and remains the subject of both political (including US Congress) scrutiny and ongoing litigation in US courts. Accordingly, those seeking to do business in the United States, whether through a US entity or through a non-US entity registering to do business in the United States, should seek guidance with respect to the requirements of the CTA in effect at such time.

I. Securities Laws

Securities laws have been enacted by the federal government to regulate the offer and sale of securities for the protection of investors and to assure the integrity of the US financial markets. That protection is

afforded through requirements that material information about an investment be disclosed to investors. Securities laws can be implicated even if no sale of securities is ultimately made.

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

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

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

J. Government Contracting

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

K. Local and State Regulation

I. Qualification to Do Business

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

Qualifying to do business typically requires the filing of an application for authority to do business in the subject state. That application discloses basic information about the business and designates a registered agent and registered office in the state, comparable to the procedure in the state of domicile (*see* Chapter 3, *Corporation Formation and Operation*). Qualification typically requires payment of an initial fee, a recent certification of existence from the state of domicile, annual reports, and additional fees due annually. It is a straightforward process with initial approval typically within 24–48 business hours.

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

to state and with the circumstances of a particular business activity, business qualification issues should be reviewed by professional advisors.

Note that the level of activity in a state will also have implications for taxation purposes. Activity that may not be sufficient to require qualification to do business in a particular state may, nonetheless, be enough to impose tax reporting and payment obligations in that state. Minimal contacts sometimes are sufficient for imposition of state taxation. For further detail concerning state taxation, *see* Chapter 5, *Taxation of United States Operations*.

II. Business Licenses and Permits

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

Most local municipalities require (i) that business licenses be obtained from the local tax authority and (ii) that personal property used in the business be listed annually with the local tax office for local property tax purposes (a tax based on the value of those assets). In certain jurisdictions, a portion of these property taxes and/or license fees can be reduced through local economic development incentives (*see* Chapter 1, *Operations in the United States*). Also, most local municipalities have zoning, fire, and building code requirements that must be complied with when operating a business in those jurisdictions.

III. Professional Licensing

In many states, professional services (engineering, architectural, health-related, etc.) are subject to special regulation. If a non-US company is considering providing these types of services (even if only ancillary to the sale of products being manufactured), a thorough review of potentially applicable regulations should be undertaken before proceeding because fines for non-compliance can be significant.

IV. Foreign Ownership of Real Property

Many states have enacted individual reporting requirements or restrictions affecting the beneficial ownership of land (agricultural or otherwise). As of the date that this chapter was written, 18 states had their own reporting requirements related to the acquisition of real property, and over 30 states had enacted statutory regimes regulating the beneficial ownership (both foreign and corporate) of real property assets. This area of law, both at the state and federal level, is rapidly evolving, and special care should be given when considering such investments in the United States.

Additionally, as noted above and in Chapter 11, CFIUS has jurisdiction to review certain real estate transactions that afford defined property rights to a foreign person.

V. State Beneficial Ownership Legislation

Some states have enacted state statutes or have pending legislation similar to the CTA, requiring the disclosure of beneficial ownership and control information at the state level with respect to entities formed or qualifying to do business in such state. The requirements are not uniform among states, and it is unknown whether states without such statutes will follow suit. Similar to the CTA, such state legislation is evolving and changing at a rapid pace, with certain states opting to follow the lead of the CTA but others potentially requiring additional or different disclosure. Before forming a US entity or qualifying a non-US entity to do business in a particular state, it is advisable to seek guidance with respect to the latest requirements (if any) of the relevant state.

CHAPTER SEVEN

Sales Representatives and Agents

Chapter Seven -

SALES REPRESENTATIVES AND AGENTS

A. Necessity of Clear Contract Terms

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

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

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

B. Status of Representative or Agent

If the sales representative or agent is to be an independent contractor, and not a direct agent or employee of the non-US company, the contract should state this. This will be important when determining, for US tax purposes, whether a non-US company has a permanent establishment in the United States. As noted in Chapter 5, *Taxation of United States Operations*, one factor used in determining whether a permanent establishment exists is whether an agent or employee of the non-US company is present in the United States and has the power to contract on behalf of the non-US company or take other comparable action. If a non-US company wishes to avoid permanent establishment status, the contract with the sales representative or agent should expressly exclude those powers. Be aware as well that merely stating that a person is an independent contractor does not necessarily confirm that status. As discussed in Chapter 8, *Employment Law (Federal and State)*, the facts and circumstances of the particular relationship, and the applicable legal tests, which can vary by state in the United States, and not the written contract, will determine whether the person may be lawfully classified and treated as an independent contractor or an employee.

C. Scope of Duties

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

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

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

- Making contact, either in person or by telephone, with identified potential customers;
- Making presentations with respect to specific products;
- Identifying and informing the company of potential customers;
- Making on-site presentations to existing and potential customers;
- Submitting regular sales reports, information pertaining to new account development, and credit information;
- Assisting in collection of delinquent accounts;
- Complying with all applicable laws and regulations;
- Committing affirmatively not to take any action that would adversely affect the company's business reputation; and
- Performing other functions and services necessary to obtain the most effective possible distribution of the subject products.

D. Commission Arrangements

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

Sales representatives and agents sometimes prepare the contract themselves and present it to the company. Those agreements usually favor the sales representative or agent and lack a clear computation methodology for commissions or compensation. It is advisable for a non-US company to develop its own standardized agreement for use in dealing with sales representatives and agents that is materially different from its standardized computation for commissions or compensation for employees or direct agents of the company, if any, to mitigate potential misclassification issues as noted in Chapter 8, *Employment Law (Federal and State)*. The contract can be fair to both sides but clear and comprehensive in its coverage.

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

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

Applicable state law must also be considered regarding the terms of the commission structure as a number of US states have laws that regulate the payment of commissions to independent sales representatives.

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

E. Termination Provisions

Contentious situations may arise if the contract is not clear about residual obligations, if any, of the company and the sales representative or agent following termination. If commissions are to be paid for orders that arise from the sales representative's efforts during the term of the contract, but are processed following termination, that contingency must be clear and unambiguous. Residual payment obligations may sound innocent at the outset of a contract, but they can be quite costly and problematic if the relationship with the sales representative or agent is less than satisfactory. A company may have to replace the sales representative or agent with another and may find itself faced with paying two commissions on the same set of sales. Expectations should also be documented regarding confidentiality, return of the company's property by the sales representative or agent, tampering with contractual relationships of the company, and related matters.

F. Disputes

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

It is also advisable to provide for the method of resolving disputes. Possibilities range from nonbinding mediation, to binding private arbitration, to full-scale civil litigation. Factors that bear on the choice include the leverage of a particular party, each party's resistance to publicity, and the relative cost of the alternatives. The decision should be made with advice of counsel. *See* Chapter 10, *Supplier and Customer Contracts*, for further discussion of dispute resolution alternatives and applicable international conventions.

G. Other Provisions

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

- Restrictions on representing competing products or soliciting the company's workforce or customers during and for a period after the contract;
- Exclusivity or non-exclusivity of the relationship (i.e., where the sales representative or agent is expressly free or not free to provide services to other entities while providing services to the company);

- Representations and warranties by the sales representative or agent that there are no restrictions precluding his or her performance under the contract;
- Confidential and proprietary information and inventions;
- The territory covered by the contract;
- Limitations on statements that can be made by the sales representative or agent about the products;
- Restrictions on the ability of the sales representative or agent to bind the company;
- Terms and conditions on which orders are to be submitted;
- Indemnity and insurance provisions;
- Expense reimbursement policies; and
- Confirmation of independent contractor status.

CHAPTER EIGHT

Employment Law (Federal and State)

Chapter Eight -

EMPLOYMENT LAW (FEDERAL AND STATE)

A. Employment Relationship

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

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

B. At-Will Employees

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

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

C. Employment Contracts and Employee Handbooks

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

While comprehensive employment contracts may not be appropriate for rank-and-file employees, it is common to provide these employees with an offer letter at the outset of their employment, describing the position, compensation, classification, and any conditions to employment. It may also be important to require those employees to sign short agreements protecting the company's rights in confidential information and intellectual property developed by those employees during their employment, depending on the scope of their job. Additionally, depending on where the worker is located, certain state laws may require written notifications to employees regarding the terms of their compensation and benefits, even if a contract itself is not required. The law of the city and state where the worker is located, not the law where a US employer establishes its headquarters or chooses for its incorporation, will typically govern the employment relationship with that employee. With the proliferation of remote and hybrid work arrangements, it is important to be clear with employees in writing regarding their approved US work location to avoid a remote employee relocating without an employer's knowledge or approval and triggering unexpected legal consequences for both the employee and employer.

With respect to contractual commitments by employees to protect the company's confidential information, intellectual property, and other legitimate business interests, such as in non-competition and non-solicitation agreements (commonly known as restrictive covenants in the United States), and in order for these obligations and restrictions to be enforceable against employees, the employees must have received adequate consideration at the time they agree to be bound. Consideration is the exchange of something of value in return for the promise or service of the other party—like a one-time payment of money or an increase in salary or job position. For instance, if an executive, who has signed a comprehensive employment agreement and has been operating under that agreement for some time, is later asked to sign a supplemental non-competition provision that was not discussed or contemplated at the time that the executive and the company entered into the initial employment agreement, the new supplemental agreement may not be enforceable against the executive unless the executive is given some additional valuable consideration at the time that the additional restriction is imposed. It is very important that employers deal with restrictions and obligations at the outset of the employment relationship and document those items carefully in a written employment contract. Applicable state law must also be considered in these agreements as the permissibility of restrictive covenants varies widely throughout the United States, with some states imposing civil and criminal penalties on employers who present employees with unlawful restrictions.

Although employment contracts and offer letters have their benefits, they must be carefully drafted to maintain an employee's at-will status. Specifically, contracts containing certain employee protections, such as indicating a specific term of employment (for example, two years), specifying a notice of termination period, or permitting only termination for just cause, can eliminate the presumption of at-will employment. For employers with a unionized work force, the collective bargaining agreement between the employer and the union will invariably include a just cause provision, which takes the employment of the union employees outside of the at-will realm.

Many employers also find it advisable to have an employee handbook that details the various policies and procedures of the company with which employees are required to comply as a condition of employment. Those handbooks, if properly drafted and routinely updated and enforced by the employer, can help protect the employer from liability when employment disputes arise. Note, however, that it is important to include disclaimer language that the handbook is not intended to create an employment contract or alter an employee's at-will employment status. Employers should strive to strike a balance between clearly communicated polices and avoiding excessive detail that would require frequent updating or limit the employer's flexibility when handling various employment matters. Certain policies may be mandated by

various federal, state, and local employment laws where applicable to the employer's employee work locations, such as laws relating to leaves of absence, sick time, and parental leave, and laws relating to anti-discrimination and anti-harassment.

D. Restrictive Covenants

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

If properly structured, these types of restrictive covenants are enforceable in many jurisdictions in the United States, though the recent general trend is that many jurisdictions consider non-competition covenants void or unenforceable against certain employees. Most jurisdictions construe them very narrowly and look for reasons not to enforce them. It is important that any such restrictions be carefully drafted to fit within the acceptable parameters of the particular jurisdiction in which they will be enforced, such as ensuring that the employee earns the requisite annual salary or income, and that the employee receives time to review the covenants with counsel if they choose so. Further, most jurisdictions require that the restrictions be reasonable in (i) time of duration, (ii) the territory in which the restrictions apply, and (iii) the scope of the employee's restricted activity.

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

E. Intellectual Property Provisions

In the United States, many discoveries and inventions made by employees in the ordinary course of their employment typically are the property of the employer. However, it is advisable to specifically so provide in an employment agreement in order to confirm and expand the scope of the employer's rights. The employer should expressly obtain all rights in inventions or intellectual property that are related in any way to the business or proprietary property of the employer and that arise during the employee's tenure with the employer (and for a reasonable period after employment terminates). This type of provision requires that the employee cooperate with the employer in obtaining patent and other intellectual property protection. Employees should be given the opportunity to list and exclude inventions created prior to the employment relationship for clarity. Many states in the United States require that statutory notices be provided to employees when they sign assignment of intellectual property agreements, so it is important to consult with counsel to confirm that all requisite notices are provided.

F. Independent Contractor and Employee Classification

Federal and state tax and labor laws in the United States distinguish between workers who are employees and those who are independent contractors. The default assumption of these laws is that a worker is an employee. Generally, the most significant distinction between the two categories of workers is the method by which they receive payment and how taxes and withholdings are handled. Individuals classified as employees are assured to the government that their employer will comply with all of the

income tax withholding, employment tax contribution and labor law requirements applicable in an employer/employee relationship. Companies engaging true independent contractors are not subject to those regulations, and the burden is on the independent contractor to handle taxes.

Because of the regulatory bias in favor of employee status, a business must be very cautious when classifying and treating a worker or representative as an independent contractor. Workers need not be full-time to be considered employees. When in doubt, it is always safest to treat as employees workers and service providers who are integral parts of a business.

If a company intends to deal with a worker or service provider as an independent contractor, advice from counsel should be sought to determine whether independent contractor status will be upheld. In order to perform this assessment, it will be important to determine the jurisdiction in which the independent contractor will be performing services, as that state's laws will likely apply. There are a number of tests and factors (which vary by jurisdiction) that apply in making that determination, many of which focus on the degree of control that the company exercises over the tasks to be performed by the purported independent contractor, and the nature of services performed by the independent contractor. If an independent contractor is determined by a regulatory agency to actually be an employee, the employer may be liable for, among other things, (i) income taxes not withheld and remitted to the government, (ii) employment taxes required to be paid by the employer, and (iii) any claims under labor laws applicable to employers and employees (for example, overtime pay requirements, benefit and pension plan inclusion, and workers' compensation and unemployment insurance benefits). Civil and criminal penalties may also apply in certain circumstances.

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

G. Wage and Hour Requirements

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

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

H. Labor Unions

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

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

Even though an employer's workforce might not currently be represented by a labor union, organizing campaigns are undertaken by unions on occasion. The employer is subject to a number of laws and regulations that govern how the company deals with those organizing efforts and the restrictions on contacts with employees during the campaign. These matters should be discussed in detail with the company's professional advisors.

I. Anti-Discrimination Laws

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

Federal Law (common name)	Summary	Coverage
Age Discrimination in Employment Act of 1967 (ADEA) 29 U.S.C. §§ 621 et seq.	Prohibits discrimination in the hiring, compensation, termination, terms, conditions, and privileges of employment of individuals 40 years or older, based on age.	Employers engaged in industry affecting commerce who have 20 or more employees for each working day of 20 or more calendar weeks in the current or preceding year.
Americans with Disabilities Act of 1990 (ADA) 42 U.S.C. §§ 12101 et seq.	Prohibits discrimination in the hiring, compensation, termination, terms, conditions, and privileges of employment of individuals with disabilities under Title I of the ADA; other titles forbid discrimination in public services, public accommodations and telecommunications.	Employers engaged in industry affecting commerce who have 15 or more employees for each working day of 20 or more calendar weeks in current or preceding year.
Civil Rights Act of 1964 (Title VII) 42 U.S.C. §§ 2000e et seq.	Prohibits discrimination in the hiring, compensation, termination, terms, conditions, and privileges of employment, based on race, color, religion, sex, or national origin; also provides for action against sexual harassment.	Employers engaged in industry affecting commerce who have 15 or more employees for each working day of 20 or more calendar weeks in the current or preceding year.
Section 1981 of the Civil Rights Act of 1866 42 U.S.C. § 1981	Prohibits discrimination on the basis of race, color, and ethnicity when making and enforcing contracts.	All private employers and labor organizations.

J. Other Employment-Based Laws

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

Federal Law (common name)	Summary	Coverage
Employee Retirement Income Security Act of 1974 (ERISA) 29 U.S.C. §§ 1001 et seq.	Protects the interests of employees and beneficiaries in employee benefit plans and employee welfare plans, such as pension and health care plans and sets minimum standards for the management and funding of the plans.	Employers engaged in commerce who establish or maintain welfare benefit plans (such as life and health insurance) or a plan, fund, or program that provides retirement income to workers or results in the deferral of income by employees until or past retirement or their termination.
Fair Labor Standards Act of 1938 (FLSA) 29 U.S.C. §§ 201 et seq.	Establishes the federal minimum wage; requires that nonexempt employees be paid overtime for hours worked over 40 per week; requires that employees in hazardous occupations be over the age of 18; forbids employment of minors under age 14; and imposes limitations on employment of minors aged 14–15.	Employers who are engaged in commerce or production of goods for commerce. Other technical provisions may apply.
Equal Pay Act of 1963 (EPA) 29 U.S.C. § 206(d).	Requires that men and women in the same establishment receive equal pay for equal work on jobs that require equal skill, effort and responsibility and that are performed under similar working conditions.	Employers subject to the FLSA.
Family and Medical Leave Act of 1993 (FMLA) 29 U.S.C. §§ 2601 et seq. 5 U.S.C. 6381 et seq.	Requires employers to provide up to 12 weeks of unpaid leave in a 12-month period to eligible employees for the birth, adoption, or foster care placement of a child; to care for a spouse, child, or parent who has a serious health condition; and to care for themselves due to a serious health condition.	Employers engaged in industry affecting commerce who have 50 or more employees within a 75-mile radius for each working day of 20 or more weeks in the current or preceding calendar year.
Immigration Reform and Control Act 8 U.S.C. § 1324a et seq.	Prohibits employment of unauthorized aliens and requires verification of employees' right to work in the United States.	All employers.

Federal Law (common name)	Summary	Coverage
Occupational Safety and Health Act of 1970 (OSHA) 29 U.S.C. §§ 651 et seq.	Requires employers to provide employees with a workplace free from recognized hazards likely to cause death or serious injury and comply with occupational safety and health standards.	Employers engaged in businesses affecting interstate commerce.

Other notable federal laws include:

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

K. Employee Benefits

While there are very few employee benefits that are mandated by state or federal law, a non-US company should be aware that an employer has an obligation to pay a certain percentage of an employee's wage base as a contribution to the US Social Security program. While the Social Security program is operated by the federal government, funding comes from both employers and employees. The employee's portion of the contribution typically is deducted from the pay of the employee at regular intervals in the same manner and at the same time as income tax is withheld. The employer then remits to the federal government those amounts, along with the employer's contribution. Any funds that are withheld from employee paychecks for these purposes are considered trust funds. If they are not properly remitted to the federal government, both the employer and the responsible executives of the employer (personally) may be liable for payment of those funds. Employers also must pay a certain percentage of an employee's wages to the state unemployment compensation fund in the state where the employee works.

Non-US companies also should also be aware of each state's workers compensation program. All states require that most employers obtain workers compensation insurance, which is intended to compensate employees for job related injuries. If the employer is in compliance with the state's workers compensation guidelines, an employee's exclusive remedy against the employer for work-related injuries is through that program, absent egregious circumstances. Similarly, companies should also take note of each state's unemployment insurance program. All states require that most employers contribute to their unemployment insurance program, where terminated employees can apply for and obtain unemployment insurance benefits if eligible. Failure to contribute to the state's unemployment insurance program may result in civil penalties and make-up contributions.

Lastly, many states, cities, and counties in the United States now require various forms of paid sick time, paid or unpaid medical leave, and disability insurance benefits. These mandatory benefits vary widely by jurisdiction and the employer's workforce headcount in each jurisdiction. It is important to consult with counsel and for the employer to coordinate with its payroll provider to ensure that all mandatory benefits are provided and documented appropriately (e.g., in some jurisdictions, accrued benefit time must be listed on the employees' paystubs each pay period).

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

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

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

Some employee benefits are tax advantaged while others are not. Tax advantaged benefits typically provide the employer with a tax deduction, with the employees receiving the benefit with deferred or no tax consequence. Tax advantages are intended to encourage employers to adopt those benefits for their employees. Other tax advantaged employee benefits include various medical, dental, and insurance plans. Fringe benefits that, depending on the circumstances, may or may not carry tax advantages (depending upon how they are structured) include parking benefits, discount programs, and automobile and transportation packages.

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

L. Plant Closing and Layoff Regulations

Although it may never be applicable to them, all employers should be aware of the federal Worker Adjustment and Retraining Notification Act (WARN). With certain exceptions, WARN requires that an employer give 60 days' advance notification of (i) a plant closing or mass layoff that will result in significant job terminations at a single site of employment, (ii) an employment layoff exceeding six months at a single site of employment, or (iii) (in certain circumstances) a reduction in work hours. WARN is applicable to employers who employ 100 or more employees. Broadly speaking, the advance notification requirements may be triggered where (i) at least 50 employees are affected by a plant closing, (ii) 500 or more workers are laid off at a single site of employment, or (iii) 50–499 workers are laid off at a single site of employment where the layoffs constitute 33% of the employer's total active workface at the single site.

The rules of WARN are complicated and can apply in unusual ways. For instance, there is a look back and look forward testing period during which all layoffs within that test period will be evaluated to determine whether the threshold requirements have been met for application of WARN. If WARN applies, advance notices of the terminations must be given to the employees, or monetary penalties may be assessed. There are three exceptions to WARN's notice requirement: (i) faltering company, (ii) unforeseeable business circumstances, and (iii) natural disaster.

Application of WARN can be problematic in the acquisition context, especially if the new owner of the business plans to make personnel adjustments. If the former owner of the business also has made employment adjustments prior to the acquisition, the combined activities may trigger application of WARN. Whenever significant layoffs or personnel adjustments are contemplated by an employer, professional advisors familiar with WARN should be consulted.

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

M. Employee Severance

Federal and state laws do not require payment of severance to terminated employees. Severance in the United States is governed by contract. Accordingly, an employer will be obligated to pay severance only if it has contractually committed to make such payments, which may be evidenced in an employment agreement or written severance policy. Employers who do obligate themselves by contract to pay severance should be aware that severance pay is often regarded as wages, and failure to pay severance may subject the employer not only to liability for the amount unpaid, but for lawyer's fees and liquidated damages as well. Typically, when employers in the United States do elect to offer severance to departing employees, they require departing employees to execute separation agreements and releases of claims in exchange for their severance packages.

CHAPTER NINE

Immigration Law

Chapter Nine -

IMMIGRATION LAW

A. Central Role of Immigration Laws

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

If a company does not recognize immigration issues inherent in the employment context, it can unknowingly violate the Immigration and Nationality Act (INA) or the Immigration Reform and Control Act (IRCA). The basic concepts of those laws are highlighted below, as are the most common visa types used by businesses in order to legally employ foreign nationals.

Foreign nationals who work without authorization are subject to possible fines and expulsion, as well as potential loss of visas, lawful permanent resident status, or other benefits. Companies who employ unauthorized workers or fail to confirm employment eligibility for each employee may suffer the penalties discussed at the end of this chapter. For those reasons, it is important that companies doing business in the United States have a working knowledge of US immigration laws and access to professional advisors that can deal with the particulars.

B. Immigration Status

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

I. Undocumented Aliens

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

II. Nonimmigrants

A nonimmigrant is a person granted status to enter the United States for a temporary period of time and for a specified purpose (e.g., to visit, study, work in a particular job for a particular employer, etc.). There are many categories of nonimmigrants in the US immigration system, some of which allow for employment. The term nonimmigrant generally refers to the fact that the person is not immigrating permanently and is given only temporary status.

Most nonimmigrants enter the United States with a visa stamp matching their specific nonimmigrant category. Although the visa is an important travel document, it does not establish eligibility to work in the United States. A foreign national presents the visa to customs officials when seeking admission to the United States. Once customs admits the person, he or she is given a nonimmigrant visa classification,

which usually is stamped into the passport and referred to as the I-94 Arrival/Departure Record. This I-94 Arrival/Departure Record is also **available online**. It is important to note that the period of authorized stay shown on the I-94 Arrival/Departure Record very often does not match the expiration date of the visa. This inconsistency is due to the fact that the visa itself is only an entry document, whereas the I-94 Arrival/Departure Record is the official proof of someone's nonimmigrant status. The I-94 Arrival/Departure Record, not the visa stamp, is the most important indicator of a nonimmigrant's status, purpose of entry, and duration of stay.

III. Out of Status Persons

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

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

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

IV. Permanent Residents (Immigrants)

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

V. United States Citizens

US citizenship can be acquired by birth in the United States or birth outside the United States to at least one parent who is a US citizen. Citizenship can also be acquired through a process called naturalization in which an individual adopts the principles of the US government and meets other requirements prescribed by law. Naturalization requires a certain period of lawful permanent resident status, usually three or five years depending on the specific circumstances.

C. Common Commercial Nonimmigrant Visa Classifications

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

I. B-1 Business Visitor Visa

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

II. ESTA / Visa Waiver

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

III. TN Status

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

The TN classification allows admission to the United States for a maximum initial period of three years, which can be extended once more for a total of six years. The TN is considered a strict nonimmigrant category such that it is not permissible to seek lawful permanent resident status. The worker's spouse

and children under 21 are eligible to enter in TD (Trade Dependents) status, but that status does not permit employment in the United States.

IV. H-1B Specialty Worker Visa

Foreign nationals may be admitted in H-1B status as specialty occupation workers if they possess a US bachelor's degree in a specialized field of study, an equivalent foreign degree, or equivalent years of experience, and work in a profession that requires the degree. H-1B visa holders are only authorized to work for their sponsoring employer. The H-1B classification process is complex and requires participation in an annual H-1B lottery, as well as pre-approval from the United States Department of Labor (DOL). The DOL process includes posting a notice at the worksite about the wages that will be paid to the H-1B worker. The required wage targets are set by the DOL as well, and it is a serious violation to fail to pay an H-1B worker the required wage.

An H-1B visa is initially issued for a three-year period and may be extended for an additional three years. The worker's spouse and children under 21 may be included in the petition and are eligible for H-4 visas. The H-4 visas allow the family members to travel with the H-1B employee to the United States. Currently, H-4 spouses are allowed to apply for work authorization, but this rule is subject to change by the current administration.

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

V. L Intracompany Transferee Visa

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

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

VI. E-1 Treaty Trader / E-2 Treaty Investor Visa

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

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

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

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

VII. O-1 Visa

Foreign nationals of extraordinary ability in the sciences, arts, education, and business may qualify for an O visa, when those individuals have an extensive publication record, have made outstanding contributions to their fields of endeavor according to their peers, and have membership in professional associations that require outstanding achievement of their members or can satisfy other criteria set forth in regulations. The initial period of stay in O status can be up to three years, with extensions granted in increments of up to three years. O visa holders are authorized to work only for their sponsoring employers. Like the E and the L, the O-1 application is rather document intensive and approvals can be relatively challenging.

D. Employment-Based Immigrant Status

The immigrant process is commonly referred to as the green card process and, in many cases, requires the foreign national to have an offer of employment and be sponsored by a US employer. In other cases, the extraordinary ability category as an example, a foreign national may apply based on his or her Nobel Peace Prize-type accomplishments, without the need of a sponsor. The United States has a complex system of annual limits on green cards, including limits for particular categories as well as per-country limits. Each year, demand for green cards exceeds supply, resulting in backlogs and waiting periods for green cards that can last more than 10 years in some cases.

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

The second common approach is the labor certification process. Under this approach, before a company can ask USCIS to issue an immigrant visa to an employee, the company must follow strict and complex DOL guidelines to actively recruit to find a qualified US worker for the position. In other words, the law requires that companies test the labor market to determine whether qualified US citizens or permanent

residents are available to perform the job. The employer can move forward with the green card process only if DOL certifies that there are no qualified US workers available.

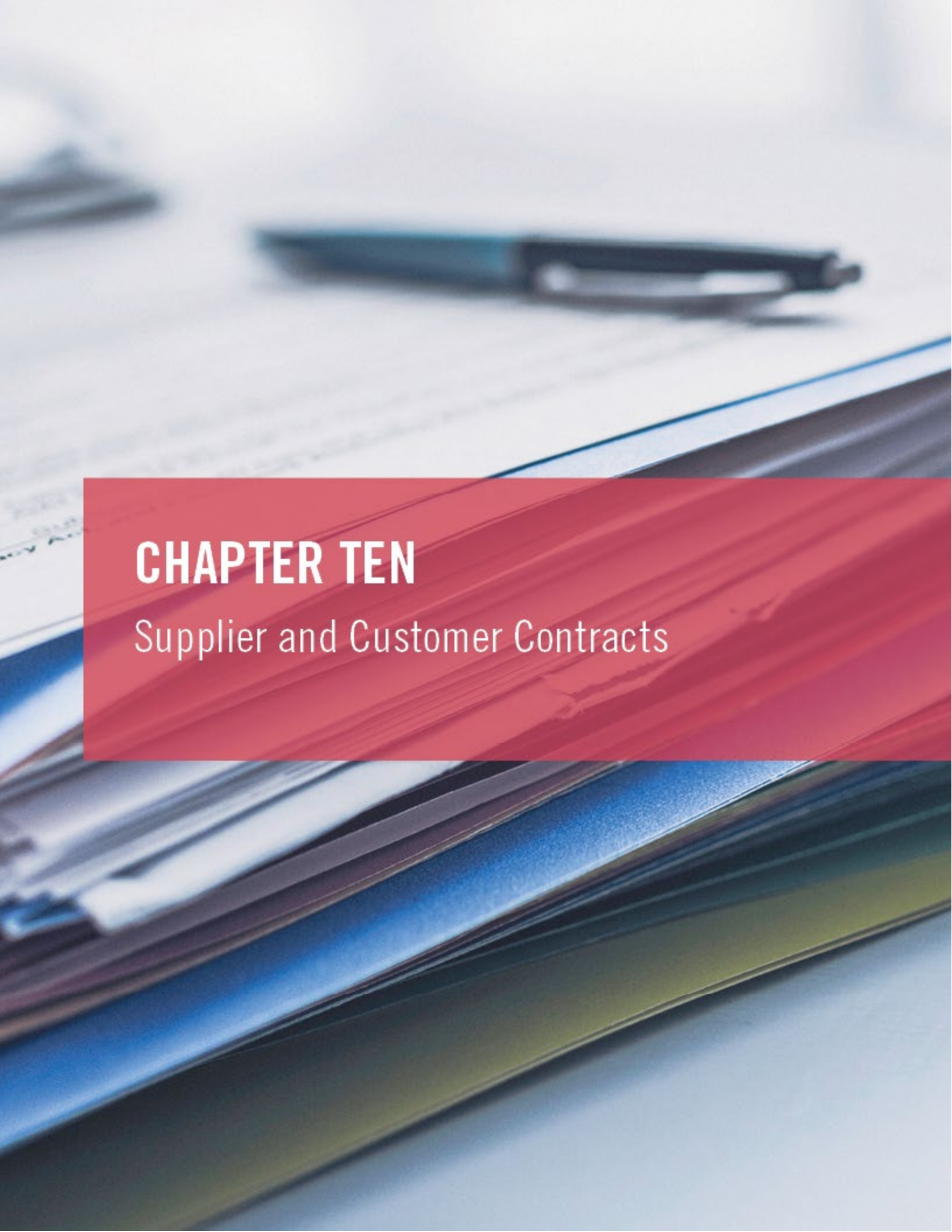
The green card process can be very time-consuming and frequently becomes backlogged and delayed at the DOL and USCIS. Consequently, companies that desire to obtain immigrant status for, and permanently employ, foreign nationals should seek counsel early in the nonimmigrant's stay, rather than waiting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

E. Compliance with Immigration Laws

In 1986, IRCA was enacted by the US Congress to end employment of unauthorized foreign nationals. Since the IRCA was enacted, employers have been obligated to verify that workers they hire are authorized to work in the United States. The Form I-9 is used for this verification process and must be completed for all hires. Section 1 of the Form I-9 must be completed on the first day of hire by the employee, and Section 2 must be completed within three business days of hire by the employer. Section 1 consists of the employee's personal information, and Section 2 is where the employer must personally inspect and confirm the documents presented by the employee to prove his or her right to work. IRCA impacts employers in the following ways:

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

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



CHAPTER TEN

Supplier and Customer Contracts

Chapter Ten -

SUPPLIER AND CUSTOMER CONTRACTS

A. Necessity of Clear Contract Terms

In the United States, contracts determine the relative rights and duties of parties in commercial dealings. Accordingly, clear and comprehensive contracts with customers and suppliers are fundamental to successful operations in the United States. Even strong commercial relationships can deteriorate quickly if misunderstandings arise over items that could have been documented at the outset of the relationship.

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

B. Applicable Law and Conventions

If a commercial relationship with a customer or supplier is to be conducted wholly within the United States, the law of the state specified in the contract generally will govern the relationship. Typically, the governing law specified in the contract is that of a commonly accepted neutral state (i.e., Delaware or New York), or the state of domicile of one of the parties. Parties may also use other non-commonly accepted states as the governing law, but caution must be exercised as the chosen state may not be respected by a court if it has no relationship to the parties or the contract's performance. Each state would apply statutory law (principally the Uniform Commercial Code as adopted by that state) and its common law. As mentioned in Chapter 1, Operations in the United States, laws are sometimes general in nature. Consequently, even though some guidance may be provided by law, material terms of the arrangement should be set forth in detail in the contract.

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

If both parties to an international contract are domiciled in CISG contracting states, the contract must expressly state that the CISG does not apply if the parties do not want its application. Otherwise, the CISG will automatically apply to the contract. Parties may consider opting out of the CISG due to an increased familiarity with the Uniform Commercial Code, common law, or relative state law over the CISG.

For example, if a US company and an Australian company enter into a contract for the sale of goods in the United States, the CISG will automatically apply (since both of those countries are CISG contracting

states), unless the parties have expressly stated in the contract that the CISG will not apply. No reference to the CISG is required in order for it to apply. It automatically applies, unless otherwise expressly excepted.

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

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

The countries listed on **Attachment 2** at the end of this guidebook have adopted the CISG (subject to various reservations and declarations by certain of the countries). The list includes most countries of the industrialized world (note, however, the conspicuous absence of the United Kingdom). The CISG has not been adopted in its entirety by every contracting country. Some have opted out of, or modified, certain provisions. For example, Argentina departs by requiring that a contract for the sale of goods must be in writing.

C. Contract Formation

A contract is formed and binding on the parties when an offer has been made and accepted. A binding contract must also contain consideration by both parties, which means that the parties bargained for the exchange of something of value under the contract. Exactly when an offer and acceptance occurs, and the exact terms and conditions of that offer and acceptance, are sometimes open to debate and can result in significant disputes between parties. Confusion as to when offer and acceptance occurs is compounded by the various forms and correspondence that are traded among the parties during the negotiation process (proposals, letters of intent, deal points, order forms, acknowledgment forms, invoices, etc.). E-mails alone may contain sufficient terms to create a contract. Parties to negotiations need to be alert to the fact that their actions at any point during that process may be sufficient to create a binding contract (even though that might not have been their intention). Further, parties must be aware that certain contracts must be in writing to be considered valid.

Parties should approach all documentation and correspondence in a manner so that no contract will be formed until all of the material terms have been agreed to, the party is ready to be bound under the contract, and the appropriate signatures of authorized representatives have been obtained (on the contract itself or in accordance with applicable electronic signature laws).

Note, also, that, even if a contract has not been formed, parties to a negotiation still may have some potential liability to each other based on equitable principles. For instance, if one party to a negotiation relies to its detriment on a representation or encouragement provided by the other party, with the other

party's knowledge and acquiescence (e.g., by making significant purchases of raw materials or making capital investments in tooling, based on expectations improperly created by the other party), the party detrimentally affected may be able to recover its damages from the other party. Consequently, it is important to make sure that, in the negotiation process, no unintended representations are made and that the correspondence is clear that no binding obligations arise (and no actions should be taken or are authorized) until a definitive contract is signed by all parties.

D. Delivery Terms

Dealing with delivery arrangements would seem to be a simple matter. Unfortunately, significant disputes can arise if the parties are not clear as to their respective responsibilities. Because of the risk of confusion, customers and suppliers of goods typically rely on standardized terminology (summary acronyms such as FOB, FAS, EXW, etc.). Those terms have been developed to describe the rights and duties of the parties under various delivery arrangements.

In the context of transactions involving international deliveries, the International Chamber of Commerce has developed standard terms known as Incoterms®. First published in 1936, and updated periodically, Incoterms® (a shortening of International Commercial Terms) are a compilation of 11 standard delivery and transportation key words. Each Incoterm® allocates responsibilities in a different way with respect to:

- Packaging, marketing, counting, weighing and similar requirements;
- Export clearance (including licenses and other authorizations and customs formalities);
- Carriage of goods from the supplier to the customer (including procurement of insurance);
- Where delivery takes place;
- Notice requirements (including desired carriers, delivery time and proof of delivery);
- When risk of loss transfers;
- Division of costs; and
- Import clearance (including licenses and other authorizations and customs formalities).

Using Incoterms® can eliminate the necessity of drafting pages of contract provisions to cover details of those transportation responsibilities. Each Incoterm®, by its nature, encompasses most of the details of those concepts. To incorporate an Incoterm®, a contract must simply reference the appropriate Incoterm®, state the applicable destination or place of origin, and refer to the appropriate version of Incoterms®. For most international customers and suppliers, the use of Incoterms® has become commonplace.

Incoterms® are divided into the following four main categories according to the 2020 version, which is the most recent version of Incoterms at the time this chapter was written.

- **EXW** (Ex Works). Minimum obligations imposed on the supplier—make the goods available to the customer at the supplier's premises.
- **FCA** (Free Carrier), **FAS**, and **FOB**. The supplier is to transfer the goods to a carrier, free of risk and expense to the customer.
- **CFR** (Cost and Freight), **CIF**, **CPT** (Carriage Paid To), and **CIP** (Carriage and Insurance Paid To). The supplier is to arrange for the transfer of goods, free of risk and expense to the customer; however, the risk of loss passes from the supplier to the customer at a point in the supply route prior to the goods reaching the delivery destination.
- **DAP** (Delivered at Place), **DPU** (Delivered at Place Unloaded), and **DDP** (Delivered Duty Paid). Maximum obligations imposed on the supplier—the supplier must arrange transfer, pay for, and ensure that all the goods arrive at a stated destination.

Differences between Incoterms® falling within each of the last three categories above generally relate to (i) the mode of transport (e.g., FCA applies to any mode of transport, while FOB and FAS are used only for sea transport), (ii) incremental costs/responsibilities (e.g., under DPU, the supplier is responsible for unloading, while, under DAP, the customer is responsible for unloading), and (iii) risk of loss transfer (e.g., under FAS, risk of loss transfers when the goods are placed alongside the ship, while, under FOB, risk of loss generally transfers when the goods are placed on board the ship).

Incoterms® do not address various other issues involved in the sale of goods. Most notably, they do not:

- Reference the method or timing of payment;
- Address when title, or ownership of the goods, passes from the supplier to the customer;
- Specify which documents must be provided by the supplier to the customer to facilitate the customs clearance process at the customer's country; or
- Address liability for the failure to provide the goods in conformity with the contract of sale or for delayed delivery.

Note also that the Uniform Commercial Code definitions of particular terms (to the extent they have not been repealed in a particular state) may vary somewhat from the definition in Incoterms® (most notably, FOB), and the coverage of Uniform Commercial Code provisions sometimes is not as comprehensive as Incoterms®. Each contract should specify which definitional provisions will apply when using a standardized delivery term (Uniform Commercial Code or Incoterms®).

E. Specifications and Payment Terms

The contract should provide specifications and standards applicable to the subject goods or services. Inspection rights, product or service warranties, and other procedures for what happens if goods or services are not delivered in the required condition should be set forth in detail. It should also be kept in mind that, if the contract is not explicit with respect to acceptance and payment procedures, the law applicable to the contract (i.e., the Uniform Commercial Code, the CISG, etc.) may provide default guidance on certain aspects of the matter (which may or may not be what the parties intend).

It is also important that the contract state payment terms and conditions. Basic issues to be covered include (i) procedures for issuing invoices, (ii) when the obligation for payment arises (e.g., upon receipt of the invoice versus upon delivery date), (iii) any discounts for prompt payment, (iv) whether and how interest will accrue on unpaid invoices, (v) the extent to which any supplemental charges will accrue, (vi) mechanisms for price increases, (vii) the method of payment (e.g., wire transfer, certified funds, regular bank check, etc.), (viii) invoice content (including detail on specific products and services, applicable taxes such as sales and use taxes, etc.), (ix) identifying which party will be responsible for taxes (including withholding tax, sales tax, and use tax), (x) the currency in which payment is to be made, (xi) procedures for any disputed invoices, (xii) reimbursable expenses, and (xiii) the right, if any, to offset payment amounts against other obligations between the parties. Note that tariffs (i.e., customs duties imposed on imported goods) can greatly increase the cost for parties importing goods into the United States. Parties can include provisions in contracts to adjust or mitigate the tariff burden.

F. Term and Termination Provisions

Supplier and customer contracts will contain a provision dealing with the length of time that the relationship will remain in place. As is the case with other contract provisions, there are innumerable possibilities, including (i) an initial term for a certain number of months or years, with either an option to renew, an automatic renewal or no renewal right, or (ii) an open-ended term.

Provisions should also be included to address the possibility of a breach under the contract. The contract might grant to the non-breaching party (i) the right to terminate the contract unilaterally and immediately upon notice to the breaching party, (ii) the right to terminate the contract after notifying the breaching party of the breach and permitting the breaching party the opportunity to cure the breach in a specified period, or (iii) some variation of those rights.

In addition to termination for breach, a change of control of a party might also be an event that triggers termination, since the other party might not be comfortable continuing to do business with the successor owners. The definition of a change of control can be as elaborate as the circumstances require and can include situations in which less than a majority of a party's ownership changes.

A contract may also include a termination for convenience right for one or both parties, allowing a party to terminate for no reason upon some form of notice (and sometimes with having to pay a termination fee).

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

G. Dispute Resolution

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

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

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

Arbitration, like mediation, involves the participation of a third-party arbitrator, but the procedure is more structured than mediation, and, if the parties have so agreed in the contract, the decision will be binding and enforceable in the courts. Rules of arbitration facilitate a more in-depth review of the situation. The parties should choose, in advance, the arbitration rules that will be applicable (e.g., those provided by the AAA, JAMS, ICC, or other body).

The advantages of arbitration include the following:

- An international treaty, referred to as the New York Convention, requires that courts in treaty countries recognize and enforce arbitral awards. The countries listed on **Attachment 3** at the end of this guidebook are parties to the New York Convention (subject to various reservations and

declarations by certain of the countries). There is no analogous general international treaty for enforcement of judgments resulting from court litigation.

- Use of an internationally recognized arbitral organization, such as the AAA, JAMS, or the ICC, may prove to be helpful in enforcing an arbitral judgment, as it will appear more likely that the arbitration was conducted fairly and appropriately.
- The parties may require that the arbitration be confidential, which could be critical if the dispute involves trade secrets.
- The arbitration provision might require that the arbitrator have expertise in a particular industry, making it more likely that the arbitrator will understand the intricacies of the dispute.

Some disadvantages of arbitration include:

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

The fourth type of dispute resolution process is litigation. The principal benefit of litigation is its structured and imposing nature and the right to appeal decisions to higher courts. Parties tend to feel the gravity of matters more acutely in court proceedings, which are public and conducted in accordance with sometimes elaborate, established procedures. For additional discussion of the US court system, *see* Chapter 1, *Operations in the United States*.

H. Warranties and Liability Limits

A supplier or customer contract should address the extent to which goods or services carry warranties and the remedies for breach of warranties. A customer may want extensive warranties with few limitations, such as a blanket warranty stating that the goods or services will operate and perform in accordance with the requirements set forth in the contract and for their intended purpose.

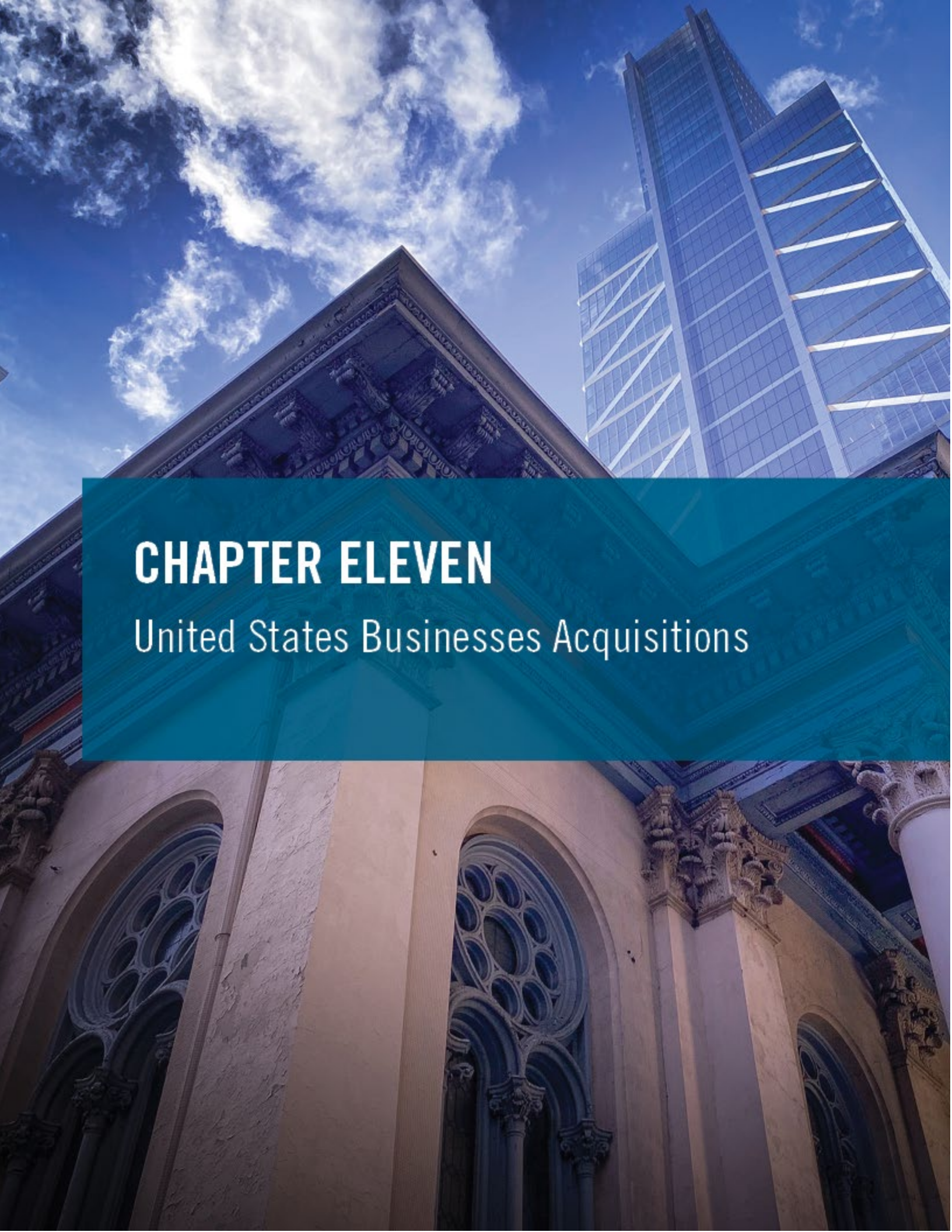
On the other hand, a supplier may want to limit its warranties only to those explicitly expressed by the supplier in the contract, with other implied warranties expressly disclaimed. Suppliers frequently disclaim (in conspicuous writing) the implied warranties of merchantability and fitness for a particular purpose, which, absent an express disclaimer, may be imposed by applicable law, or any other implied warranties arising in the ordinary course of dealing or usage of trade. In some states, certain warranties may not be disclaimed, especially when consumer goods are involved.

Since the supplier generally bears more liability risk, the supplier will seek to limit the scope of potential liability for its breach by attempting to exclude or disclaim indirect, incidental, consequential, punitive, exemplary and similar damages, and by capping overall liability. The customer, on the other hand, typically will resist those limitations to the extent possible, preferring that all possible types of damages remain available for recovery and that liability is uncapped or capped at a high amount.

I. Other Provisions

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

rights or duties under the contract, (xiii) the ability of affiliated companies to join in the arrangements, and (xiv) limitations on generative AI.



CHAPTER ELEVEN

United States Businesses Acquisitions

Chapter Eleven -

UNITED STATES BUSINESS ACQUISITIONS

In deciding whether to make a significant investment in the United States, a non-US company will start up new operations *de novo* (typically referred to as a greenfield investment), acquire a business that is operating in the United States, or establish a joint venture that will undertake the greenfield investment or business acquisition. The reasons for choosing one method over the other will be varied and will depend on the specific circumstances. By choosing a greenfield investment, the non-US company will establish an entity in the United States and obtain the appropriate licenses and permits. This process is discussed in further detail elsewhere in this guidebook (including Chapter 2, *Entity Selection*), and flow charts laying out the formation process of a corporation and a limited liability company are attached to the end of this guidebook as **Attachment 2**. For a discussion of joint ventures, *see* Chapter 12, *United States Joint Ventures*. This chapter will discuss acquisitions of businesses operating in the United States.

The acquisition of a US company (Target Company) by a non-US company or by a subsidiary entity owned by a non-US company (Buyer) typically involves the Buyer purchasing either all of the equity ownership of the Target Company (a stock acquisition) or substantially all of the assets of the Target Company (an asset acquisition). This chapter is intended to highlight a few of the fundamental issues that arise in an acquisition in the United States. However, many of the other chapters also address particular issues that will be faced in any such acquisition (*see*, e.g., Chapter 8, *Employment Law (Federal and State)*, which discusses mandatory notices under the Worker Adjustment and Retraining Notification Act (WARN).

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

A. Due Diligence

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

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

B. Documentation

Business acquisition agreements in the United States tend to be lengthier and more detailed than is sometimes customary in other countries. Hopefully, this minimizes potential disputes following the closing of the transaction by having the parties thoroughly discuss and resolve the significant issues of the transaction and clearly articulate that resolution in the definitive acquisition agreement.

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

I. Recitals or Statement of Purpose

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

II. Definitions

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

III. Purchase and Sale

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

IV. Representations and Warranties

This section sets forth representations and warranties of the Target Company, and perhaps its shareholders, on which the Buyer will rely. Topics covered may be comprehensive and typically include:

- The title to and condition of the assets and properties;
- Existence of litigation;
- Accuracy of financial statements and the absence of liabilities not included in the financial statements;
- Status of customer and supplier relations and related material contracts;
- Authority to conclude the transaction;
- Absence of conflicts, including no need for consents or approvals;
- Status of employee relations and employee benefit plans;
- Protection of intellectual property and data privacy;
- Violations of laws;
- Real estate and environmental matters; and
- Absence of material tax issues.

If the Target Company (or its shareholders) cannot make a representation because it would be untrue, then those exceptions are listed on a schedule that is attached to the acquisition agreement.

Representations and warranties serve these purposes:

- Bring to light potential liabilities and problems associated with the business;
- Confirm exactly what is being purchased;
- Allocate risk for liabilities that may not be known by either party (e.g., a spill of hazardous substances by a prior owner of the property on which the business is being operated);
- Force the Target Company (or its shareholders) to think carefully about all aspects of its business;
- Provide a basis for imposition of indemnification liability (see discussion below);
- Assist the Buyer in due diligence and in understanding the business of the Target Company; and
- Identify any consents from or notices to government entities that may be legally required or advised given the circumstances of the transaction.

In essence, they serve to justify the purchase price and any required adjustments to be made after the closing. In addition, it has become customary in the United States for the Buyer to disclaim reliance on any information or materials made available by the Target Company or its sellers in diligence unless it is covered by representations and warranties in the acquisition agreement. Such disclaimer may prevent the Buyer from obtaining any remedy with respect to a claim that information provided in diligence (for which there is no representation or warranty in the acquisition agreement) was incorrect. As such, the Buyer should ensure that the representations and warranties in the acquisition agreement cover all matters that may be important to the business of the Target Company.

V. Interim and Post-Closing Covenants

Certain covenants and agreements may be necessary when the parties are signing the agreement on one date but closing the transaction on a later date. These interim operating covenants are primarily intended to ensure that the Target Company continues to operate in the ordinary course of business and to protect the value of the business between signing and closing, but also address other relevant matters. Typical pre-closing covenants might include those covering:

- Restrictions on the Target Company's operation of the business, other than in the ordinary course of business;
- Cooperation in seeking consents and approvals (including antitrust approvals) to the transaction;
- Cooperation with the Buyer in finalizing the terms of any financing that the Buyer may need for the transaction; and
- A no-shop requirement (prohibiting the Target Company and its shareholders from soliciting or entertaining offers to purchase from third parties).

Covenants applicable to the post-closing period might also be required and could include those covering:

- Non-competition or non-solicitation obligations (to prevent the Target Company or selling shareholders from competing with the Buyer in the same business that it just sold or to solicit the employees or customers of such business);
- Confidentiality requirements;
- Tax return procedures for any periods that straddle the closing date; and
- The handling of existing litigation or other claims against the Target Company.

VI. Conditions to Closing

This category lists the conditions that each party must satisfy in order to trigger the other party's obligation to close the acquisition. Common conditions include (i) delivery of officer certificates confirming the accuracy of the representations and warranties and necessary approval of the shareholders of the Target Company, (ii) obtaining consents to the acquisition from governmental authorities and third parties (such as approvals from antitrust authorities and consents from any landlords and licensors), (iii) delivery of other agreements (such as employment agreements from key employees, escrow agreements, restrictive covenant agreements, etc.), (iv) the performance of the parties of the covenants in the acquisition agreement that are required to be performed prior to the closing (which may include actions required to ensure a successful financing), and (v) delivery of bills of sale and assignments (if an asset acquisition) or stock certificates (if a stock acquisition and the stock is certificated).

VII. Termination

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

VIII. Indemnification

For acquisitions of private Target Companies in the United States, an acquisition agreement may include an indemnification section, which provides the responsibilities and certain remedies of the parties in the event of a breach of the acquisition agreement or a claim made by a third party relating to the acquired business. It typically addresses (i) the limits, if any, on the indemnification obligations of the Target Company or its owners, such as a cap on liability, (ii) a deductible or basket that must be exceeded before indemnification obligations will commence, (iii) a time limit for bringing indemnification claims, and (iv) procedures for notice and defending third party claims for which indemnification is being sought. If, however, the Buyer has agreed to obtain RWI, an acquisition agreement may not have any indemnity provisions, which would require the Buyer to rely exclusively on the RWI as protection for the transaction, or it may include only a limited indemnity provision having a cap based on the deductible under the RWI.

IX. Miscellaneous

This category addresses miscellaneous matters such as notice arrangements, governing laws, procedures for modification of the agreement, methods for resolving disputes, waivers of conflicts to permit sellers' counsel to continue representing such sellers (even though such counsel may also have represented the Target Company in the transaction), and allocation of rights with respect to attorney-client privileges that the Target Company may have regarding work product or communication from such counsel in connection with the transaction. Even though denoted as miscellaneous, these provisions have important implications and require careful review.

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

C. Stock Acquisitions

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

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

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

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

The disadvantages of a stock acquisition include the following:

- Because the Target Company continues in operation, the amount invested by the Buyer in the stock of the Target Company is at risk, since that investment may suffer as a result of claims against the Target Company relating to matters that arose prior to the acquisition, whether or not known at the time of the acquisition; and

- For US income tax purposes, the assets of the Target Company retain their historic tax basis, so that the depreciation basis remains unchanged and typically is not stepped up to reflect the purchase price paid for the stock (absent certain special tax elections or other circumstances that should be addressed with US tax counsel).

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

D. Asset Acquisitions

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

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

The disadvantages of asset acquisitions include the following:

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

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

E. Hart-Scott-Rodino Antitrust Clearance

Under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR Act), parties to transactions that meet certain monetary thresholds are required to submit premerger Notification and Report Forms with the US antitrust agencies – the Federal Trade Commission (FTC) and United States Department of Justice Antitrust Division (DOJ) – and observe a waiting period before closing. Specifically, the size of transaction and size of person tests must be met.

Size of Transaction: The size of transaction test is met if the acquiring party, the ultimate parent entity (UPE) of the acquiring party, or the UPE's other controlled subsidiaries will hold voting securities, assets, or non-corporate interests of the acquired entity or entities with an aggregate value of (a) more than US$126.4M up to US$505.8M if the size of person test is also met or (b) more than US$505.8M, regardless of whether the size of person test is met.

Size of Person: The size of person test is met if the UPE, together with controlled subsidiaries, of one party has annual net sales or total assets of US$252.9M or more and the UPE, together with controlled subsidiaries, of the other party has annual net sales or total assets of US$25.3M or more according to its most recent regularly prepared consolidated financial statements that are no more than 15 months old.

These figures were effective as of 10 February 2025 and are revised each year based on the percentage change in the US gross national product.

Analysis of the applicability of the HSR Act is complicated, since several exemptions may apply and reportability may depend upon whether the Target Company is a corporation, limited liability company or partnership and whether the acquisition is one of voting securities, non-voting securities, or assets. Notably, there are HSR exemptions that apply to certain foreign-to-foreign transactions and acquisitions of foreign assets that do not have sales in or into the United States exceeding the base size of transaction threshold (US$126.4M as of 10 February 2025).

If a transaction is reportable under the HSR Act, each party must separately fill out a Notification and Report Form, which includes information regarding corporate structure (shareholders, subsidiaries, minority holdings), governance, transaction structure and rationale, overlapping products or services, vertical supply relationships, prior transactions, and foreign subsidies – as well as so-called business documents analyzing the transaction or overlap areas with respect to various competition issues.

On 10 February 2025, the FTC enacted an overhaul of the rules implementing the HSR Act. The new HSR rules transformed the premerger notification process, requiring parties to provide several new categories of documents and information in their filings. For many transactions, the new rules have significantly increased the cost and time required to prepare HSR filings.

Submission of the parties' HSR filings triggers a 30-calendar-day waiting period during which the reviewing agency conducts its initial assessment of the transaction's potential impact on competition (in certain narrow circumstances, the waiting period may be shorter). Following this initial review: (1) if the transaction does not raise significant competition concerns, the reviewing agency may simply let the

waiting period expire, concluding the HSR process (the agencies do not issue official clearance letters);[1] (2) if the reviewing agency has questions that can be quickly addressed, the parties may pull and refile their notifications, restarting the 30-day clock; or, (3) if the agency has significant concerns that the transaction may harm competition, it can issue a Request for Additional Information and Documentary Materials (Second Request). A Second Request is an extremely broad subpoena for documents, information, and data that accompanies an in-depth Phase II-style investigation, during which the waiting period is tolled. The majority of notified transactions are cleared within 30 days. Importantly, the agencies have the authority to investigate and challenge transactions, even if they are not reportable under the HSR Act, including post-consummation.

Experienced HSR counsel should be consulted to determine whether a filing is necessary and in making any filings. The civil penalty for failure to comply with the HSR Act is US$53,088 per day (as of 10 February 2025 and subject to annual adjustment) for each day of violation, which may be imposed on the Buyer, the Target Company and any of their responsible officers.

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

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

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

[1] The parties may request early termination of the 30-calendar-day HSR waiting period, but it will be granted only in the sole discretion of the FTC and DOJ. If early termination is granted, the names of the buyer and seller UPEs and any acquired entities, as well as the date of the grant, are published on the FTC's website and in the Federal Register.

business. Because of the difficulty in defining CFIUS's precise scope of review, as well as risk of review long after transaction closing, CFIUS has become one of the prime regulatory concerns for non-US parties contemplating acquisitions and investments in the United States.

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

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

Parties must, however, notify CFIUS in two situations: (i) certain covered transactions that involve a TID US business that produces, designs, tests, manufactures, fabricates, or develops critical technologies (defined as including most commodities, software, and technology subject to export licensing requirements under US laws, including the Export Administration Regulations and the International Traffic in Arms Regulations), and (ii) transactions that would result in an entity in which a non-US government has a substantial interest (defined as 49% or greater) obtaining a substantial interest (defined as 25% or greater) in a TID US business. The failure to submit a required notice can result in penalties of up to the value of the relevant transaction.

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

FIRRMA also provided CFIUS with jurisdiction to review certain purchases or leases by, or concessions to, a non-US person of real estate in the United States that fall outside the scope of a covered transaction as discussed previously. CFIUS jurisdiction in particular applies to certain acquisitions, leases, and concessions of real estate that are (i) within or that operate as part of certain US maritime ports or airports, (ii) within a defined proximity range of identified critical US military and intelligence facilities (one mile or 100 miles depending upon the facility), (iii) within certain areas proximate to US ballistic missile facilities, or (iv) within certain offshore US military zones. Although no mandatory filing is required, parties to transactions that involve real estate that falls under CFIUS's real estate jurisdiction may want to consider filing a notice with CFIUS to confirm that no unresolved national security concerns exist.

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

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

G. Reporting Requirements for Foreign Direct Investment

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

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

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

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

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

H. Other Governmental Restrictions or Regulations Affecting Acquisitions by Non-US Persons

There are various US export control and other non-US policy and national security related regulations and administrative programs that can materially affect the feasibility or desirability of acquisitions and in some cases may require additional notifications to the government not described above. The following is a brief overview of these regulations and administrative programs. In addition, depending on the industry and nature of the acquisition, other industry-specific regulatory considerations also may come into play.

I. US Export Controls - EAR and ITAR

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

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

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

The ITAR and the EAR are relevant to a proposed acquisition of a US business in the following circumstances:

- To the extent that due diligence by the non-US investor requires access to controlled technology, export authorization may be required to conduct such due diligence.
- If the acquisition involves an ITAR-registered business, the registrant must notify DDTC of the intended acquisition by a non-US person at least 60 days in advance of closing. The notification provides DDTC with an opportunity to require approval of the transfer of ITAR-controlled items to the purchaser (a requirement that is ordinarily not exercised). In addition, new ownership could affect the nature and speed of export approvals that will be granted to the business, which could affect the value of the business being acquired. Within five days of closing, the US business must update its ITAR registration to reflect the new ownership (whether non-US or domestic) and provide relevant ownership information.
- Existing export licenses held by the US business may require government approval for transfer. The failure to effectively coordinate and time the transfers or amendments can result in a disruption of the US business activities post-acquisition.

- To the extent that the US business to be acquired has technology subject to export controls, access to the technology by, or any transfer of the technology to, the non-US owner or managers, including management post-acquisition, could require licenses or approvals that may not be granted. These licensing requirements can impact planned management arrangements and plans to integrate or facilitate joint activities between the acquired business and businesses of the Buyer outside the United States.
- Compliance with export controls is a high priority of the US government, which imposes significant penalties for compliance failures. The penalties and other consequences for compliance failures generally are considered to continue through successor liability principles with the business that is acquired. Accordingly, it is critical to assess any possible past or ongoing compliance failures as part of the acquisition due diligence process.

II. US Trade Embargoes - OFAC Regulations

The United States currently maintains various economic sanctions programs, administered principally by the United States Department of the Treasury's Office of Foreign Assets Control (OFAC). Sanctions can be comprehensive or selective and against countries, individuals, or entities for a variety of foreign policy and national security reasons, such as war, terrorism, cyberattacks, nuclear proliferation, and human rights abuses. Individuals and entities subject to comprehensive sanctions restrictions are identified on various restricted party lists maintained by different US government agencies, most prominently OFAC's Specially Designated Nationals and Blocked Persons List.

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

III. Government Contract and Security Clearances

If the US business has a facility security clearance (FCL) for access to classified information under US contract programs, it cannot be subject to foreign ownership, control, or influence (FOCI). If a non-US person is contemplating acquiring or investing in a US business with an FCL, the non-US person should be prepared to be subject to mitigation measures if the business intends to maintain its security clearance. Arrangements to maintain the business's clearance must be resolved in advance of the acquisition through a notification to and commitment letter with the Defense Counterintelligence and Security Agency (DCSA). DCSA works with the US business and foreign acquirer or investor to determine the appropriate form of mitigation to eliminate FOCI, which could include adoption of board resolutions to separate foreign directors and officers from the cleared business, hiring of independent directors to handle prerogatives of ownership related to cleared work, or a proxy agreement whereby proxy holders exercise all prerogatives of ownership and have the freedom to act independently from the non-US acquirer or investor, with certain exceptions. Acquisitions requiring FOCI mitigation review will frequently

trigger CFIUS review jurisdiction as well. Parties therefore coordinate filings so that CFIUS and DCSA reviews occur simultaneously.

Additionally, legislative initiatives periodically seek to disqualify or put at a disadvantage US businesses owned by non-US persons in competing for at least certain types of US government contracts. Those initiatives often focus on ownership involving countries deemed to present a strategic risk for the United States, such as presently the People's Republic of China. These risks also should be evaluated for possible impacts on the valuation of the acquisition.

IV. Immigration Laws

To the extent that the post-acquisition business plan for the acquired business includes the assignment of non-US nationals to the United States in management or other capacities, it is important to evaluate immigration / visa requirements that may apply. Doing so ensures that the plan is feasible and allows for coordination of arrangements for the necessary immigration law approvals in order to avoid unnecessary delays and disruptions in putting management plans in effect post-acquisition. Further, if the business to be acquired is, itself, foreign-owned, then the continued status of any non-US nationals in the business after the acquisition will also need to be analyzed. Since the terror attacks of 11 September 2001, the US visa processes have been somewhat less predictable in terms of both whether a visa will be issued in a particular case and the length of time for processing. For a further discussion of US immigration laws, *see* Chapter 9, *Immigration Law*.

CHAPTER TWELVE

United States Joint Ventures

Chapter Twelve -

UNITED STATES JOINT VENTURES

A. Joint Ventures in the United States

Domestic and non-domestic parties use joint ventures to become more competitive and to promote the development, manufacture, assembly, distribution, and sale of components, products, technology, and services in the United States and around the world. In the past, it was common for joint ventures to be relatively self-contained business units that could be operated, bought, and sold separately from the joint venture participants. However, today's joint ventures are usually not fully self-contained business units and can be separated from the participants without some difficulty or pre-planned disassembly. Today's joint ventures usually provide different benefits to each of the participants (as seen, for example, in a joint venture between a company selling batteries and an automobile company selling battery-powered cars) and therefore are not as easily severable from the parties as are self-contained businesses.

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

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

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

B. Appropriate Legal Entity

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

In some countries, a special form of legal joint venture entity is used for a joint venture. However, in the United States, there is no form of legal entity called a joint venture. With very limited exceptions, such as joint venture characterizations of certain business relationships in federal regulations applicable to doing business with the US government, the term joint venture is a business colloquial term in the United States that has little or no legal significance.

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

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

C. State of Formation

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

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

D. Joint Venture Documentation

The documentation for formation and governance of joint ventures in the United States consists of corporation or limited liability company documents that are required by state statute, as well as additional documentation that addresses other rights and obligations of the parties applicable to the joint venture (such as the management and governance structure, rights of first refusal, drag-along rights, tag along rights, registration rights, and contribution obligations). Statutory and case law may impose certain limits on the provisions that the parties can agree to, such as restrictions on distributions that impair payments to creditors, and restrictions on waivers of certain fiduciary duties. The formation and governance documentation will be governed by the law of the state in which the joint venture entity is formed.

In addition, joint ventures usually also have commercial contracts, such as license agreements, manufacturing agreements, supply agreements, sales agreements, and service agreements. These commercial contracts can be governed by the laws of any state upon which the parties agree, so long as there is some basic nexus with that state (e.g. where the contract will be performed or a party has a presence), and they do not have to be governed by the law of the state in which the joint venture entity is formed.

E. Dispute Resolution

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

F. Regulatory Matters

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

CHAPTER THIRTEEN

Customs, Duties, and Tariffs

Chapter Thirteen -

CUSTOMS, DUTIES, AND TARIFFS

A. Introduction

Customs laws are designed to serve various governmental policy objectives. By imposing controls on the importation of goods, customs laws promote revenue collection through tariffs, protection of the health and safety of citizens (e.g., to keep out consumer products that have not received required approvals), prohibit the entry of contraband and items that may violate US patents and trademark rights, and enforce remedies against unfair trade and product-specific protections such as anti-dumping, anti-subsidy, safeguards laws, and trade retaliatory measures under Section 301 of the Trade Act of 1974. The United States Department of Homeland Security is charged with, among other things, administering and enforcing customs laws and regulations, which it does primarily through two agencies, US Customs and Border Protection (CBP) and US Customs and Immigration Enforcement (ICE).

Some goods can be exported to the United States relatively easily and free of restrictions. Other items, however, are subject to prohibitions, restrictions, and quotas. International trade treaties such as the United States-Mexico-Canada Free Trade Agreement (USMCA), bilateral trade agreements between the United States and multiple other countries, including Chile, Israel, Jordan, and South Korea, and multilateral agreements under the World Trade Organization (WTO) are integral parts of that regulatory system.

Tariffs were reduced over time under the WTO and the preceding General Agreement on Tariffs and Trade (GATT), with many items reduced to zero or near zero duty. However, starting with actions by the first Trump administration in 2018, unilateral tariffs imposed by the United States have increased import duties, in some cases significantly, including new tariffs on Chinese goods and on a range specific product categories under Section 301 of the Trade Act of 1974 and Section 232 of the Trade Expansion Act of 1962.

The US importer (the importer of record) bears the primary responsibility for declaring the valuation, classification, and rate of duty for goods entering the United States, all of which are subject to review and acceptance by CBP. The importer of record is also responsible for payment of all duties, taxes, and fees that are owed on the entry. The relationship between the importer of record and CBP is one of informed compliance. CBP informs the international community of applicable rules and restrictions, and importers must conduct their businesses accordingly. If an importer fails to voluntarily adhere to those rules, CBP will impose enforced compliance. An important aspect of this system is that the importer must exercise reasonable care in its importing activities. The failure to use reasonable case may result in the making of incorrect entries and lead to a series of adverse consequences including detention, seizure, and forfeiture of goods, civil and criminal penalties, and denial of certain importing privileges. CBP routinely imposes civil penalties for misstatements made in connection with entering merchandise, including as to value and classification of the merchandise.

B. Customs Laws and Procedures

The steps for importation into the United States of goods consist of entry, examination, and liquidation, each of which is discussed below.

I. Entry

When physical goods arrive at a port of entry, the owner, purchaser, or a licensed customs broker must file entry documents with CBP to clear the goods through customs. In many cases, the importer will hire an agent or licensed customs broker to handle this function, which requires the importer to execute a power of attorney in favor of the customs broker. There are special requirements when a non-resident acts as the importer.

For most imports, the importer of record must submit an Entry Summary including information relevant for CBP's assessment of the imported item including the classification under the Harmonized Tariff Schedule of the United States (HTSUS), valuation, rates of duty, duties and fees owed, and country of origin. In addition to filing the necessary documents, a bond must be posted with CBP to cover duty, taxes, and fees likely to be incurred. An importer may obtain a bond through a US surety company to cover a single transaction (single entry) or continuous transactions (annual). A high-volume importer should investigate the possibility of obtaining a continuous bond covering entries at all ports in the United States for a 12-month period.

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

II. Examination

The next step involves examination of the goods, the chief purposes of which are to determine (i) whether the goods have been properly classified under the HTSUS, (ii) the value of the goods for customs purposes and their dutiable status, (iii) whether the goods are properly marked with the country of origin and have been correctly invoiced, (iv) whether the shipment contains prohibited articles, and (v) whether the goods listed on the invoice match those actually shipped. Most shipments clear customs in a paperless manner with the entry information being electronically processed through the customs system.

Other US federal agencies also may have an interest in the imported goods. Because CBP officials are located at each port of entry, they routinely enforce regulations on behalf of those other agencies. Examples of targeted goods include:

- Food products, drugs, and cosmetics (the Food and Drug Administration);
- Agricultural commodities (the Department of Agriculture);
- Alcohol, tobacco, firearms, and explosives (the Bureau of Alcohol, Tobacco, Firearms and Explosives); and
- Motor vehicles (the Department of Transportation and the Environmental Protection Agency).

Additionally, the Office of Foreign Assets Control (OFAC) administers sanctions and embargo programs that may prohibit imports from certain countries. A list and description of such programs can be found at OFAC's website. For an overview of OFAC and its sanctions and embargo programs, *see* Chapter 11, *United States Business Acquisitions*.

III. Liquidation

If the entry documents are accepted by CBP as submitted by the importer without changes, the entry will be liquidated as entered. Liquidation is the point at which the entry, including the rate and amount of duty, becomes final for most purposes. During this process CBP may contact the importer of record with a request for information to assist in the assessment of the entry. In the event that CBP determines that the entry cannot be liquidated as entered—for example, the importer's HTSUS classification or valuation of the goods—CBP will usually notify and provide the importer with an opportunity to respond if the correction will result in owing higher duties (or will authorize a refund of deposited duties if the duty rate is more favorable to the importer). If CBP concludes that the entry is in error, it will liquidate the entry and bill the importer for any additional duty owed. If the importer is not satisfied with the duty rate decision of CBP, a protest may be filed.

C. Foreign Trade Zones

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

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

D. United States-Mexico-Canada Free Trade Agreement

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

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

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

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

E. Tariffs and Duty Calculation

I. The Current Tariff Landscape

Currently, goods imported into the United States may be subject to multiple tariff measures; in many cases these measures stack such that importers must pay the cumulative duties resulting thereunder. These measures include:

- **General Rate of Duty or Most Favored Nation (MFN) Duty Rates**
  These duties are listed in the Harmonized Tariff Schedule of the United States (HTSUS), with different rates depending on the country of origin and HTSUS classification. This is the primary import duty regime predating the increased tariff activity starting in 2018.

- **Section 301 of the Trade Act of 1974**
  The primary Section 301 tariffs in effect are the additional duties on imports from China, stemming from the 2018 investigation into technology transfer, IP practices, and industrial policies. These tariffs cover hundreds of billions in annual trade across four original lists, with rates generally from 7.5% to 25%, with higher rates (up to 100%) applying to strategic sectors like electric vehicles, solar cells and modules, semiconductors, batteries, steel and aluminum products, and medical goods. The Trump administration has threatened other tariff measures under Section 301, such as duties targeting autos, steel, semiconductors, batteries, and machinery imports from 16 countries, and another 60 countries targeted for forced labor practices.

- **Section 232 of the Trade Expansion Act of 1962**
  Section 232 allows the US president to impose tariffs or quotas on imports that threaten national security, following investigations by the Department of Commerce. Both the first and second Trump administrations have been active in using Section 232 to impose duties on a broad range of product categories including steel, aluminum, copper, metal derivative products, automobiles, auto parts, and lumber and wood products.

- **Anti-dumping and countervailing duties (AD/CVD)**
  AD/CVD measures are special duties on classes of imports from specific identified countries alleged to be sold in the United States at unfairly low prices (below cost of production or a comparable home market price) or that benefit from foreign government subsidy. These measures can be imposed after an investigation conducted jointly by the US International Trade Commission and the US Department of Commerce.

In April 2025, the Trump administration imposed broad reciprocal tariffs on most imports and certain additional tariffs on Canadian, Chinese, and Mexican imports using claimed authority of the International Emergency Economic Powers Act (IEEPA). However, in February 2026 the US Supreme Court ruled that IEEPA does not grant the president authority to implement tariffs and invalidated the IEEPA-based tariff measures. The administration quickly pivoted to impose across-the-board 10% tariffs under Section 122 of the Trade Act of 1974, which temporarily authorizes the US President to impose tariffs up to 15% or quotas for up to 150 days to address fundamental international payments problems. The Trump administration has indicated that it would use a combination of other tariff authorities, such as under Section 301 and Section 232, to effect the same broad scope of the invalidated IEEPA tariffs.

Tariff measures are very much in flux, with potentially significant duties imposed on a wide range of goods for the near future. Importers must practice thorough diligence to understand the tariff landscape and what duty rates may apply to imports.

II. Assessment of Correct Duties

To determine which tariffs apply to imported merchandise, one must confirm the goods' country of origin, and HTSUS classification. Goods with material and labor inputs from multiple countries are considered to be a product of the last country in which processing created a substantial transformation of the materials and components into a product with a different character, name, and use. Classification requires a close review of the HTSUS, applying its rules of interpretation. The tasks of confirming a product's classification and country of origin require a careful analysis of prior CBP rulings on the same or similar merchandise. In some cases, it may be necessary to request a ruling from CBP to confirm classification or country of origin.

The amount of duty owed depends on the value declared for the merchandise during entry. CBP regulations governing the valuation of imported merchandise are extensive and somewhat complex. However, the preferred method of valuation is transaction value—the price actually paid or payable for the merchandise when sold for exportation to the United States. However, in some cases transaction value is not available or not usable, such as where the buyer and seller are related and there are concerns about the relationship affecting the price paid or payable. In that case the importer will be required to use an alternative basis for valuation, such as the value of identical or similar merchandise, or a value based on a downstream sales price or upstream production costs. The transaction value declared to CBP should include amounts equal to the following, if applicable:

- The packing costs incurred by the buyer.
- Any selling commission incurred by the buyer.
- The value, apportioned as appropriate, of any assist (as assist is something of value the buyer gives to the seller to produce the item).
- Any royalty or license fee that the buyer is required to pay, directly or indirectly, as a condition of the sale.
- The proceeds of any subsequent resale, disposal, or use of the imported merchandise that accrues, directly or indirectly, to the seller.

F. Trade Remedies Laws

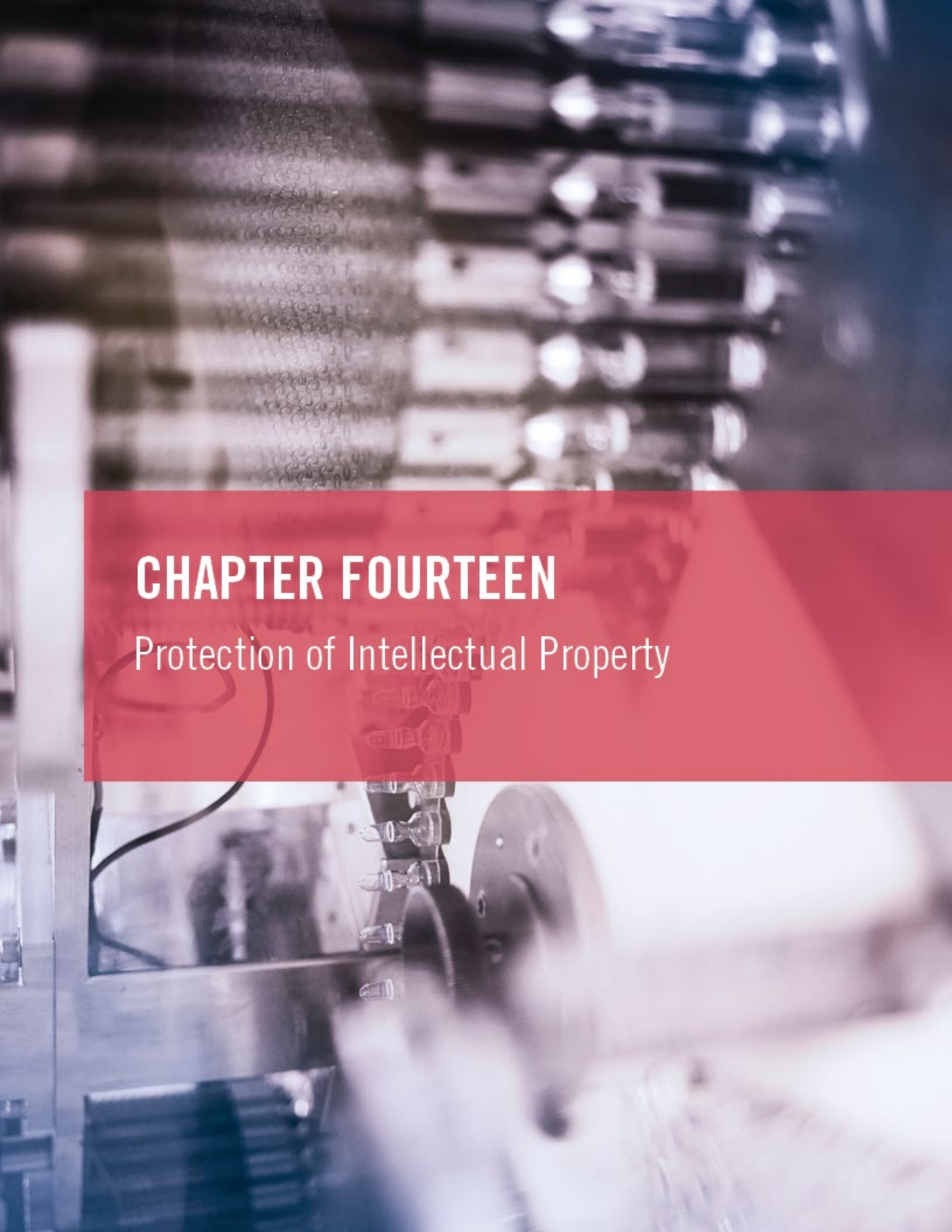
As noted, the United States enforces an array of laws that target and counteract unfair practices among US trade partners, the primary measures being anti-dumping (AD) and anti-subsidy or countervailing duty (CVD) laws. AD/CVD laws target imports of specific classes of products from specific countries.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

G. Import Quotas

Import quotas limit the quantity of certain types of goods that may be imported into a country during a particular period of time. Tariffs are monetary charges that attach to imported goods. The use of import quotas was largely banned under the WTO. However, quotas are still permitted for limited commodities, and in some cases the United States may unilaterally impose quotas in some situations. Products that have been subject to quota recently include certain sugar, cheeses, steel, and aluminum.

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

Tariff-rate quotas do not restrict the amount of imports that may enter the United States during a given period of time. Instead, they restrict the number of goods that may enter the United States at a reduced duty rate during a quota period. Once the quota has been met, goods may continue to enter the United States, but at a higher duty rate. An importer should consult with CBP about tariff-rate quotas, as they may not apply to all exporting countries.



CHAPTER FOURTEEN

Protection of Intellectual Property

Chapter Fourteen -

PROTECTION OF INTELLECTUAL PROPERTY

A. Introduction

Intellectual property has been part of United States law since the ratification of the US Constitution in 1788. Among the enumerated powers vested in Congress is the power to "promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."

US intellectual property law provides protection for patents, trademarks, copyrights, and trade secrets. In general, non-US persons and companies may obtain and enforce US intellectual property rights on substantially the same basis as US nationals, subject to applicable statutory and procedural requirements. US intellectual property rights are territorial: rights granted under US law generally protect conduct occurring in the United States and do not by themselves confer protection in other countries. For companies engaging with the US market, effective protection typically requires timely filings, clear ownership documentation, appropriate contractual protections, and proactive enforcement measures.

For business planning purposes, patents generally protect functional inventions; copyright generally protects original expressive works; trademarks generally protect brand names and other source identifiers; and trade secrets generally protect valuable confidential business information. Inbound companies should evaluate these forms of protection together rather than in isolation, particularly when launching products, entering license arrangements, hiring personnel, and developing digital marketing and online sales channels.

B. Patents

I. US Patent Protection

Patent rights in the United States are governed principally by the US Patent Act, adopted by Congress pursuant to the constitutional authority discussed above. A patent applicant may seek US patent protection by filing directly with the United States Patent and Trademark Office (USPTO) or, where applicable, through international filing procedures that ultimately require entry into the United States patent system. When issued, a US patent grants the patent owner the right to exclude others from making, using, selling, offering for sale, or importing the claimed invention in the United States. A US patent does not create patent rights outside the United States, and a patent issued in another country does not create patent rights in the United States.

II. Types of Patents Available in the United States

US law recognizes three principal categories of patents: utility patents, plant patents, and design patents.

A utility patent may be available for a new and useful process, machine, manufacture, composition of matter, or improvement thereof. This category includes many functional inventions, such as mechanical devices, chemical compounds, pharmaceuticals, and certain biotechnological inventions.

A plant patent may be available for a distinct and new plant that is capable of asexual reproduction, other than certain excluded tuber-propagated plants. Plant patents may also extend to algae and certain fungi.

Plants reproduced by seed may instead be protected under other legal regimes, including the Plant Variety Protection Act, or in some cases by utility patent if the applicable requirements are satisfied.

A design patent may be available for a new, original, and ornamental design for an article of manufacture. Design patents protect nonfunctional visual features rather than utilitarian aspects of a product.

III. Requirements for Patentability

In general, a claimed invention must satisfy several requirements to be patentable in the United States, including subject matter eligibility, novelty, non-obviousness, and utility.

Patentable subject matter generally includes processes, machines, articles of manufacture, compositions of matter, and improvements thereof. Certain categories are excluded from patent protection, including abstract ideas, laws of nature, and natural phenomena. Examples of excluded subject matter may include certain mathematical concepts, certain methods of organizing human activity, mental processes, and naturally occurring human genes and the information they encode. The abstract idea exclusion is often applied to software inventions, so when drafting a patent application directed to a software invention care must be exercised to ensure that the application is not directed to a patent-ineligible abstract idea.

To be patentable, a claimed invention must be new. Novelty may be defeated if, before the effective filing date, the invention was patented, described in certain patents or published applications, described in a printed publication, in public use, on sale, or otherwise made available to the public. These issues may arise from disclosures or commercial activity by the inventor, affiliated entities, or third parties. US law provides a limited grace period for certain disclosures made within one year before the effective filing date.

Even if an invention is novel, it is not patentable if it would have been obvious to a person of ordinary skill in the relevant field at the time of the invention. In assessing obviousness, courts and the USPTO consider factors such as the scope and content of the prior art, the differences between the prior art and the claimed invention, the level of ordinary skill in the art, and objective evidence of non-obviousness. Secondary considerations may include commercial success, satisfaction of a recognized need, failure of others, and unexpected results.

IV. Patent Application

A patent application may be filed by the inventor, an assignee, or a party to whom the inventor has an obligation to assign the invention. In commercial practice, applications are commonly filed by companies that employ or sponsor the inventors. Where multiple inventors contribute to an invention and ownership has not otherwise been allocated by agreement, they may be joint owners, with significant consequences for licensing and enforcement. In general, US law follows a first-inventor-to-file system, subject to limited exceptions such as derivation proceedings.

Because ownership and enforcement rights often depend on a clear chain of title, companies should ensure that employee, contractor, and development agreements properly address invention assignment and related cooperation obligations.

V. Patent Application Process

Because priority generally depends on filing, prompt filing is often important. Under current US law, a patent is not available if, before the date the patent application for an invention is filed, the invention was patented, described in a printed publication, or in public use, on sale, or otherwise available to the public before the effective filing date of the claimed invention; or described in a patent issued or in an application published in which the patent or application names another inventor and was filed before the effective

filing date of the claimed invention. In such circumstances, the invention is said to be anticipated and not novel.

Unlike many other countries, the United States provides a limited grace period for certain disclosures within a year prior to the effective filing date of the application. A disclosure made one year or less before the effective filing date of the application will not prevent a patent from issuing if: the disclosure of the claimed invention was made by the inventor or by another who obtained the claimed subject matter from the inventor; or the claimed subject matter had, before such disclosure, been publicly disclosed by the inventor or another who obtained the claimed subject matter from the inventor.

Even with the existence of a limited grace period, public disclosure before filing can create substantial risk and should generally be avoided unless the matter has been carefully reviewed with patent counsel.

VI. Duty of Candor

Persons involved in prosecution of a patent application owe a duty of candor and good faith to the USPTO, including a duty to disclose information known to be material to patentability. Failure to comply with that duty may render an issued patent unenforceable. This duty may apply not only to inventors and prosecuting counsel, but also in some cases to relevant company personnel.

VII. Patent Term

As a general matter, a US utility patent is enforceable for 20 years from the earliest relevant filing date, although the actual expiration date may be affected by a range of statutory and procedural factors.

VIII. Patent Marking

Once a patent application has been filed with the USPTO, the applicant may use the designation “patent pending” or “patent applied for.” These notices indicate that an application has been filed but do not themselves create enforceable patent rights.

Once a patent has issued, US law encourages patent owners to mark patented products in order to give notice to the public. This may be done by physical marking using “patent” or “pat.” together with the applicable patent number, or by virtual marking through a web address that associates the product with the relevant patents. If a patented product is not properly marked, recovery of damages may be limited for infringement occurring before the accused infringer receives actual notice of the patent.

IX. Maintenance Fees

To keep a US patent in force, the patent owner must pay maintenance fees to the USPTO within the applicable statutory periods and grace periods. Failure to do so may result in lapse of the patent.

X. Patent Infringement

Patent infringement generally occurs when a patented invention is made, used, sold, offered for sale, or imported into the United States without authorization during the patent term. Importation into the United States, or certain sales or uses in the United States, of a product made by a process patented in the United States may also constitute infringement. Anyone who induces another to infringe a patent is also considered to have infringed the patent. Infringement of even one valid claim can be sufficient to establish liability. Further, under certain circumstances, a product or process that does not literally possess all elements of a patent claim may still infringe under the doctrine of equivalents if it performs substantially the same function in substantially the same way to achieve substantially the same result. Remedies may include damages, which are at least a reasonable royalty, and in appropriate cases injunctive relief.

XI. Challenging a US Patent

An issued US patent is presumed valid. Validity may be challenged either before the USPTO or in federal court. In federal court, invalidity must generally be established by clear and convincing evidence, whereas certain USPTO proceedings apply a preponderance-of-the-evidence standard. Although a patent owner is not required to sue immediately upon learning of potential infringement, damages for pre-suit infringement are generally limited to the six years preceding the filing of the action.

XII. Patentability Searches and Freedom-to-Operate Opinions

Before investing heavily in commercialization, a company often considers a patentability search to identify prior patents or publications that may affect novelty or non-obviousness. A separate freedom-to-operate analysis evaluates whether a proposed product or process is likely to infringe third-party patents. Such opinions can be useful risk-management tools, but patent searches and legal opinions have inherent limitations. Relevant patents or applications may be missed because of classification or database limitations, keyword selection, or the temporary nonpublication of pending applications, and claim scope may remain uncertain until prosecution is complete.

XIII. International Protection for Patents

Patent rights are territorial. If protection is desired outside the United States, patent rights ordinarily must be sought separately in other countries. The Patent Cooperation Treaty provides standardized procedures for international patent filing, allowing an applicant to file a single international application and later pursue protection in designated countries within the applicable national-phase deadlines. The United States and approximately 175 other countries are parties to the Paris Convention for the Protection of Industrial Property. The Paris Convention provides national treatment and a priority system under which an applicant who files in one signatory country generally has one year to file corresponding patent applications in other signatory countries while preserving priority to the earlier filing date.

C. Copyright

I. Overview

Copyright protects original works of authorship fixed in a tangible medium of expression. Protection extends to both published and unpublished works and may cover works perceptible either directly or with the aid of a machine or device. Copyrightable subject matter includes literary works, computer programs, musical works, dramatic works, pictorial, graphic, and sculptural works, audiovisual works, sound recordings, and architectural works, among others. Copyright requires originality, meaning independent creation plus at least a minimal degree of creativity, but unlike patent law it does not require novelty.

II. US Copyright Law

Like patents, the power to protect copyrights is grounded in the US Constitution. The US Copyright Act is the federal statute that governs copyrights in the United States. It expressly preempts state laws within the general scope of copyright, and international treaties extend copyright protection across many countries without requiring local registration in each country.

III. Copyrightable Subject Matter

Copyright does not protect ideas, procedures, processes, systems, methods of operation, concepts, principles, or discoveries as such, regardless of how they are described. Facts alone are not protected. However, an original selection, coordination, or arrangement of factual material may be copyrightable if the work as a whole reflects original authorship. To qualify for protection, the work also must be fixed in a tangible medium of expression.

IV. Copyright Ownership

Copyright initially vests in the author or authors of the work. Absent an agreement to the contrary, works created by independent contractors generally belong to the individual creator rather than the commissioning company. By contrast, works created by employees within the scope of employment are generally treated as works made for hire, in which case the employer is deemed the author and owner. Joint authors ordinarily co-own the copyright in a joint work unless an agreement provides otherwise. The copyright owner has the exclusive right to reproduce the work, prepare derivative works, distribute copies to the public, publicly perform the work, and publicly display the work.

Because many businesses rely on consultants, software developers, designers, and marketing agencies, companies entering the United States should ensure that service agreements clearly address authorship, work-made-for-hire status where applicable, assignment of rights, and use of pre-existing materials.

V. Copyright Registration

Although copyright arises automatically upon fixation, in the United States registration with the US Copyright Office remains important. Registration creates a public record of the claim, is generally required before filing an infringement action in court, and may provide significant evidentiary and remedial advantages. For example, timely registration may support eligibility for statutory damages and attorneys' fees, and registration may also facilitate customs recordation and perfection of a security interest. Registration generally requires submission of an application, a deposit copy, and the applicable fee. To obtain the benefits of registration for the full copyright term, the work must be registered within ninety days of first publication.

VI. Term of Copyright Protection

In general, copyright protection lasts for the life of the author plus 70 years. Works made for hire, anonymous works, or pseudonymous works generally have a term of 95 years from first publication or 120 years from creation, whichever is shorter.

VII. Copyright Notice

For visually perceptible copies, a copyright notice traditionally consists of the © symbol (or the word "copyright" or abbreviation "copr."), the year of first publication, and the name of the copyright owner. For works first published on or after March 1, 1989, use of notice is optional but advisable. For some works first published earlier, omission of notice could affect the availability or status of protection, depending on the governing law and the circumstances.

VIII. Copyright Infringement

Copyright infringement generally involves unauthorized copying or another violation of one of the copyright owner's exclusive rights in the work. Where direct evidence of copying is unavailable, infringement may be established by showing access to the original work and substantial similarity. In the United States, federal courts have exclusive jurisdiction over copyright claims. In appropriate cases, liability may also extend to contributory or vicarious infringers.

IX. Circumvention of Technological Protection Measures

The Digital Millennium Copyright Act added provisions prohibiting unauthorized circumvention of certain technological measures that control access to protected works, as well as trafficking in certain technologies, products, or services designed to defeat such protections. These rules may apply to technologies such as encryption and other access-control mechanisms used to prevent unauthorized access to computer programs and other copyrighted works.

X. Fair Use

The Copyright Act recognizes fair use as a defense to infringement. Examples may include criticism, comment, news reporting, teaching, scholarship, research, and parody. In determining whether a particular use is fair, courts consider factors including the purpose and character of the use, the nature of the copyrighted work, the amount and substantiality used, and the effect of the use on the market for or value of the copyrighted work.

XI. Remedies for Copyright Infringement and Circumvention

Available remedies under the Copyright Act may include injunctive relief, monetary damages, and in appropriate cases attorneys' fees. Where statutory prerequisites are satisfied, a copyright owner may elect statutory damages without proving actual damages. Certain willful acts of infringement or unlawful circumvention for commercial advantage or private financial gain may also expose a violator to criminal liability, depending on the offense and the applicable statute.

XII. International Protection for Copyright

The United States and more than 175 other countries are parties to the Berne Convention for the Protection of Literary and Artistic Works. Under the Berne Convention, a copyright-protected work originating in one signatory country generally receives automatic protection under the laws of other signatory countries without the need for separate registration in those countries.

D. Trademarks

I. Trademark Protection in the United States

A trademark is a word, name, symbol, device, or other source identifier used to distinguish goods or services from those of others. Protectable marks may include trademarks, service marks, certification marks, and collective membership marks. In the United States, trademarks are protected under common law principles, state law, and the federal Lanham Trademark Act. Common law rights may arise through use without registration, but those rights are generally limited to the geographic area in which the mark is used and recognized.

II. Federal Trademark Registration

Trademarks may be registered with the USPTO. The Lanham Trademark Act generally permits both use-based applications and intent-to-use applications. An intent-to-use application allows an applicant with a bona fide intent to use a mark in commerce to seek priority before actual use begins, but actual use generally must commence before registration issues. State trademark registration is also available, although its effect is limited to the state of registration.

A federal registration provides important benefits, including prima facie evidence of rights, constructive notice, and access to federal remedies. After five years of continuous use in the United States, a trademark registration may become incontestable, which may strengthen the evidentiary effect of the registration and the owner's ability to enforce the mark, subject to applicable statutory requirements, exceptions, and defenses. Federal registration may also be recorded with US Customs and Border Protection to help prevent the importation of infringing goods.

III. Trademark Clearance and Adoption

A non-US company may be unable to use its existing non-US mark in the United States if another party has superior rights in the same or a confusingly similar mark for related goods or services in the United States. For that reason, it is often advisable to clear a mark before entering the US market and, where appropriate, to seek US registration early. Qualifying foreign applicants may in some circumstances

obtain a US registration based on a home-country application or registration under applicable treaties, even before actual use in the United States. However, continued nonuse may prevent enforcement and may expose the registration to cancellation for abandonment. Although unregistered rights can be enforced based on use, federal registration is usually preferred because it provides nationwide presumptive rights and constructive notice.

IV. Generic Terms

A generic term for a product or service cannot function as a trademark for that product or service. A mark may also become generic over time if consumers come to understand it as the common name of the product rather than as an indicator of source.

V. Maintaining and Renewing Trademark Rights

Trademark rights may potentially continue indefinitely so long as the mark remains in bona fide use as a source identifier. For federal registrations, however, the owner must also make required maintenance and renewal filings. Between the fifth and sixth year after registration, the owner must file a Declaration of Use or Excusable Nonuse, and may also file a Declaration of Incontestability if the statutory requirements are satisfied. Between the ninth and tenth year after registration, and every ten years thereafter, the owner must file the required renewal and use documents and pay the applicable fees. Failure to maintain use or to file required documents may result in loss of rights or cancellation of the registration.

VI. Trademark Term and Marking

A trademark may be protected for a potentially indefinite period, provided the mark continues to be used in commerce and continues to identify source. Federal registrations have ten-year terms but may be renewed for successive ten-year periods if use and filing requirements are satisfied. The ® symbol may be used only in connection with a federally registered mark and only for the goods or services covered by the registration. TM and SM may be used to indicate claims of common law trademark or service mark rights.

VII. Trademark Infringement and Unfair Competition

Trademark infringement generally arises from unauthorized use of a mark that is likely to cause confusion as to the source, sponsorship, affiliation, or origin of goods or services. Federal trademark law also creates causes of action for certain forms of unfair competition, including misleading advertising or labeling. Trademark disputes may be heard in federal court under federal law, and related claims may also arise under state unfair competition and trademark statutes.

VIII. International Considerations for Trademark Owners

Trademark rights are territorial. Rights established outside the United States do not necessarily confer rights in the United States, and rights established in the United States do not by themselves confer rights abroad. As a result, companies entering the US market should consider both US filings and international trademark strategy at an early stage.

E. Domain Names and Online Brand Protection

I. Domain Names and Social Media Handles

For many non-US companies entering the United States market, brand protection should include not only trademark registration, but also a strategy for domain names, social media handles, and other online identifiers. A company may find that its principal brand name is available for trademark use in some contexts but unavailable or already in use as a domain name, username, or marketplace seller identity in

others. Accordingly, companies should consider securing key domain names and major platform identifiers as early as possible in their market-entry process.

II. Online Marketplace and Website Enforcement

A company should also adopt internal procedures for monitoring potentially infringing online activity, including unauthorized use of brand names, logos, product photographs, marketing copy, and counterfeit goods sold through websites and online marketplaces. In many cases, early enforcement through platform complaint procedures, marketplace takedown mechanisms, cease-and-desist letters, and customs recordation may be more cost-effective than litigation.

III. Ownership and Control of Digital Assets

Companies should also ensure that agreements with employees, distributors, licensees, and marketing providers clearly address ownership and control of domain names, websites, social media accounts, digital content, and customer-facing online assets.

F. Trade Secrets

I. Overview

In the United States, a trade secret generally consists of information that is not generally known or readily ascertainable, derives independent economic value from its secrecy, and is subject to reasonable measures to maintain confidentiality. Trade secrets may include formulas, patterns, manufacturing methods, technical know-how, source code, customer lists, and other proprietary business information. Trade secret protection can apply to information that would not qualify for patent protection. Protection lasts only so long as the information remains secret.

II. Sources of Trade Secret Law

Trade secrets are protected under a combination of state and federal law, common law, contract, and unfair competition principles. Historically, trade secret law was primarily a matter of state law, but the Defend Trade Secrets Act of 2016 created a federal civil cause of action for misappropriation of trade secrets related to products or services used in, or intended for use in, interstate or foreign commerce. The federal statute does not preempt state trade secret law. In addition, the Economic Espionage Act of 1996 makes certain trade secret theft and misappropriation a federal crime.

III. Determining Whether Information Qualifies as a Trade Secret

In evaluating whether information qualifies as a trade secret, courts commonly consider factors such as the extent to which the information is known outside the company, the extent of internal dissemination, the measures used to protect secrecy, the value of the information, the resources spent to develop it, and the difficulty with which others could properly acquire or duplicate it.

IV. Duration and Protection Measures

Trade secret protection continues only as long as confidentiality is maintained. The owner should adopt reasonable measures to restrict access, prevent disclosure, secure storage, and limit dissemination on a need-to-know basis. Documents containing trade secret information should be clearly marked as confidential, proprietary, secret, or restricted, but labeling alone is not enough if actual security practices are inadequate. Persons given access should ordinarily be bound in advance by confidentiality or nondisclosure obligations.

In practice, reasonable protection measures should also include appropriate onboarding and offboarding procedures for employees and contractors, controls on access to shared systems and repositories, and return or deletion obligations when relationships end.

V. Misappropriation and Remedies

Trade secret misappropriation generally occurs when a person acquires trade secret information by improper means, or discloses or uses such information in breach of a duty of confidentiality. Improper means include theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy, and espionage through electronic or other means. Available remedies may include injunctive relief, compensatory damages, exemplary damages in cases of willful and malicious misappropriation, attorneys' fees in appropriate circumstances, and in some cases ex parte seizure under the Defend Trade Secrets Act.

VI. Reverse Engineering and Relationship to Patent Protection

Trade secret law does not prohibit proper means of discovery, including independent development, reverse engineering, licensing, and reliance on published literature. Accordingly, absent some other legal restriction such as contract or patent rights, a competitor may lawfully purchase a product on the open market, reverse engineer it, and use the information thereby obtained. Patent protection may in some cases offer broader protection because, even where reverse engineering is lawful, practicing a patented invention may still constitute infringement. Companies should therefore evaluate carefully whether a particular innovation is better protected by patent, by secrecy, or by a combination of both.

VII. Certain Disclosures to Government Officials

The Defend Trade Secrets Act grants immunity in certain circumstances to individuals who disclose trade secrets in confidence to government officials or attorneys solely to report or investigate a suspected violation of law, and for certain sealed court filings. To preserve the ability to recover exemplary damages and attorneys' fees under that statute, employers must give required notice of this immunity in agreements governing the use of trade secrets or other confidential information, or by cross-reference to an applicable policy.

VIII. International Protection for Trade Secrets

Under the TRIPS Agreement, the United States and many other countries provide legal protection for undisclosed business information such as trade secrets and know-how.

G. Artificial Intelligence Issues in Intellectual Property

Artificial intelligence has created important new issues in patent and copyright law:

I. Patents

In the patent context, current US law requires that an inventor be a natural person, although inventions developed by a natural person with the assistance of AI may still be patentable if the ordinary requirements of patentability are met.

II. Copyright

In the copyright context, the US Copyright Office has taken the position that a copyrightable work must reflect human authorship; purely AI-generated output without meaningful human creative input is generally not eligible for copyright protection, while human selection, arrangement, or modification of AI-generated material may support protection in appropriate circumstances. A related and rapidly developing

issue concerns whether use of copyrighted works to train AI systems constitutes infringement or may be protected by defenses such as fair use.

III. Confidentiality and Training Data

Companies using AI tools should also consider whether prompts, inputs, outputs, training materials, and system integrations may affect confidentiality, ownership, and trade secret protection. These issues are especially important where sensitive technical, customer, source-code, or strategic information may be disclosed to third-party AI systems.

H. Commercialization and Licensing

I. Overview

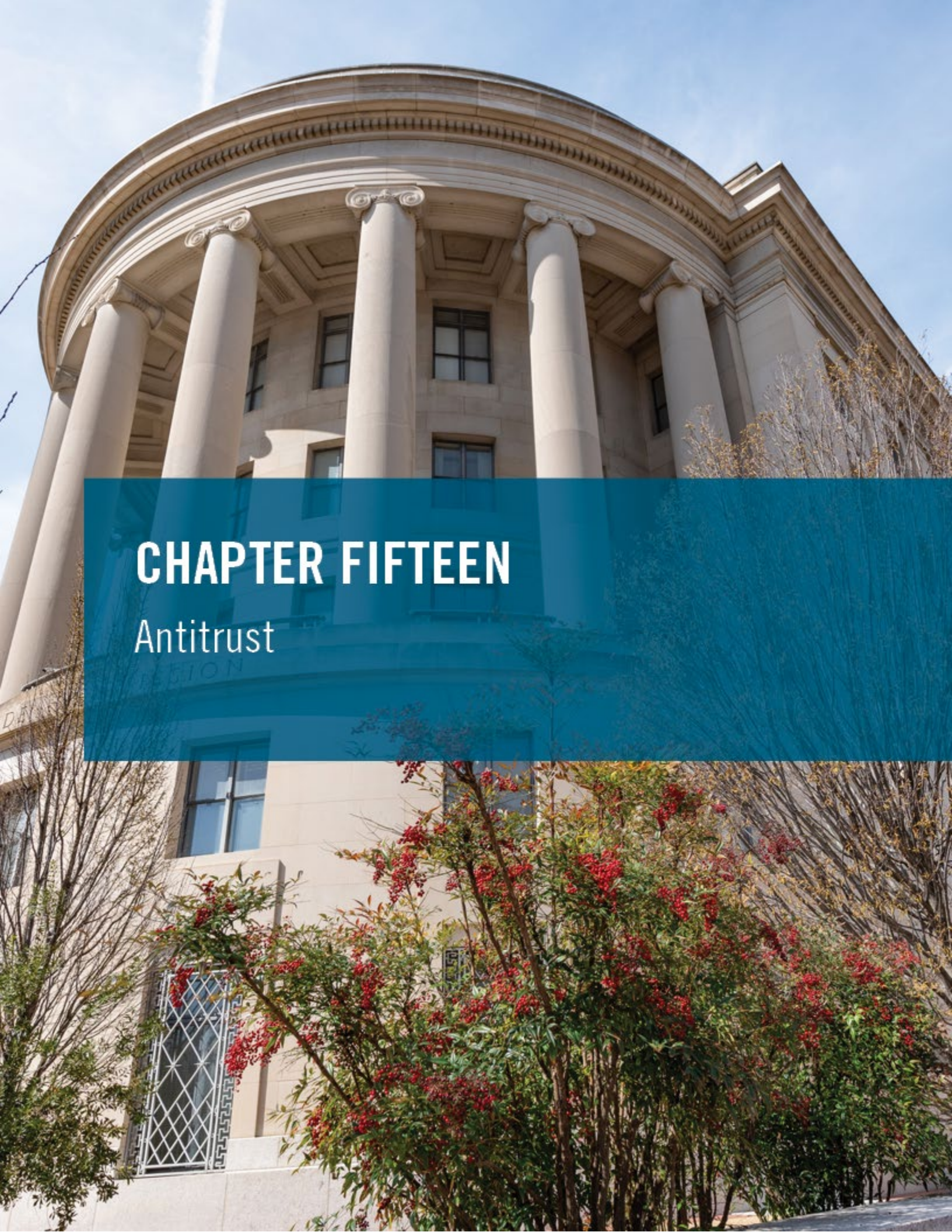
For some non-US companies, the cost and complexity of operating directly in the United States may make licensing a more practical way to commercialize intellectual property. Intellectual property licenses are generally contractual arrangements through which the owner of patent, copyright, trademark, or trade secret rights permits another party to use defined rights on stated terms.

In the United States, the legal framework governing licensing is not unitary; patent, copyright, trademark, bankruptcy, and tax issues are largely federal. However, because a license is a type of contract, state contract law generally governs interpretation and enforcement of license terms.

II. Licensing

A license to a company already operating in the United States may generate royalties or other compensation with lower operational burden, although it also reduces the owner's direct control and creates dependency on third parties. Any license should be documented in a written agreement that clearly defines the parties' rights and obligations.

Issues commonly addressed in an intellectual property license agreement include the scope of licensed rights, sublicensing authority, ownership and use of improvements, territorial restrictions, exclusivity or non-exclusivity, term and termination rights, responsibility for monitoring and enforcing intellectual property rights, marking and quality-control requirements, warranties and indemnities, confidentiality obligations, financial consideration and royalty structure, dispute resolution and availability of injunctive relief, use of the licensed material for data rights or AI training, allocation of responsibility for open-source or third-party components, and compliance with antitrust laws, export controls, and national security restrictions.



CHAPTER FIFTEEN

Antitrust

Chapter Fifteen -

ANTITRUST

A. Introduction

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

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

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

If there is a single area of law in the United States that poses a danger to the uninformed, that area is likely antitrust law, making it essential that business managers operating in the United States have a general awareness of antitrust and trade regulation laws. Sanctions for violating antitrust laws in the United States are severe and can include fines and prison terms for individuals, fines for corporations, injunctive relief, governmental contract debarment, treble damages, and lawyers' fees. Violations can also result in costly private civil lawsuits by customers, employees, competitors, or other third parties alleged to have been injured by the violation.

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

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

B. Principal Statutes and Purposes

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

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

The Clayton Act prohibits certain exclusive dealing arrangements in which the seller conditions the sale or lease of goods on the agreement by the buyer not to deal in the goods of a competing seller that substantially lessen competition, including certain tying arrangements. The Clayton Act also prohibits stock or asset acquisitions that may substantially lessen competition in any relevant market. This provision is complemented by the provisions of the Hart-Scott-Rodino Antitrust Improvements Act, which requires that certain mergers and acquisition be reported to governmental agencies prior to closing (*see* Chapter 11, *United States Business Acquisitions*). In addition, the Clayton Act prohibits certain interlocking directorships between competing corporations.

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

The Federal Trade Commission Act, although technically a trade regulation rather than an antitrust law, prohibits unfair methods of competition and unfair or deceptive trade acts or practices. As indicated by its title, this act is enforced by the Federal Trade Commission. In recent years, the Federal Trade Commission has increasingly relied on this act to investigate and pursue enforcement actions against companies engaged in conduct that, historically, was not necessarily viewed as an antitrust violation (e.g., overly broad employee non-compete clauses).

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

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

C. Sanctions and Remedies

Violation of the Sherman Act can result in criminal fines. The amount of the fines depends upon the volume of commerce affected, and corporate fines in excess of US$100 million are not unusual. Individuals, including corporate employees involved in the offending conduct, may not only be fined but imprisoned for up to 10 years. In addition, private parties harmed by antitrust violations can sue the violator for three times the amount of their actual damages (treble damages) and recover lawyer's fees (even though in the United States, generally, each party pays its own lawyer’s fees). Injunctive relief also can be granted, and violators can be debarred from bidding on government contracts. Intangible costs of these proceedings can also be substantial and include their invasive nature (permitted discovery will surprise those unfamiliar with US litigation procedures) and the immense time and resources required to defend an antitrust claim.

D. Restraint of Trade

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

Activities that are considered per se unlawful include (i) price fixing, (ii) bid rigging, (iii) customer and market allocation, (iv) certain concerted refusals to deal, (v) certain tying arrangements, and (vi) naked no-poach and wage-fixing agreements between competing employers. Per se offenses involving two or more competitors are the most harshly prosecuted activities under the antitrust laws and can result in criminal liability.

I. Dealings with Competitors

The greatest liability exposure under the antitrust laws stems from dealings with competitors. There are two primary reasons for this. First, the concept of an agreement under the Sherman Act is extremely broad. An agreement need not be formal or in writing to violate the antitrust laws—any kind of informal or tacit agreement such as a gentlemen's agreement or some other implied understanding is similarly prohibited. Some courts have even found that such arrangements can be evidenced by a wink of the eye. Second, direct evidence of an agreement is not required to establish a violation. Unlawful arrangements may be inferred from circumstantial evidence. For example, exchanges among competitors of competitively sensitive information related to prices, customers, or output can be used to infer an agreement. Therefore, all contact with competitors, whether in a trade association or in a social setting, must be approached with some measure of caution, and any discussion of prices, costs, production plans, employee wages, recruitment strategies, or similar topics should be avoided.

II. Dealings with Customers and Suppliers

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

- Selective or limited distribution;
- Refusals to deal;
- Exclusive distributorships;
- Exclusive dealing arrangements;
- Full-line forcing (e.g., bundling);
- Certain tying arrangements;
- Territorial or customer restrictions;
- Non-compete agreements; and
- Transshipping restrictions.

Although agreements between suppliers and customers regarding the price at which the customers may resell the product were for many years considered per se violations of the Sherman Act, in 2007 the US Supreme Court reinterpreted the statute to hold such agreements between a supplier and its customers to be illegal only when the agreement in fact adversely affects consumers. However, a number of states' antitrust laws continue to treat such vertical pricing agreements as unlawful per se (e.g., California).

E. Monopolies

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

F. Mergers and Acquisitions

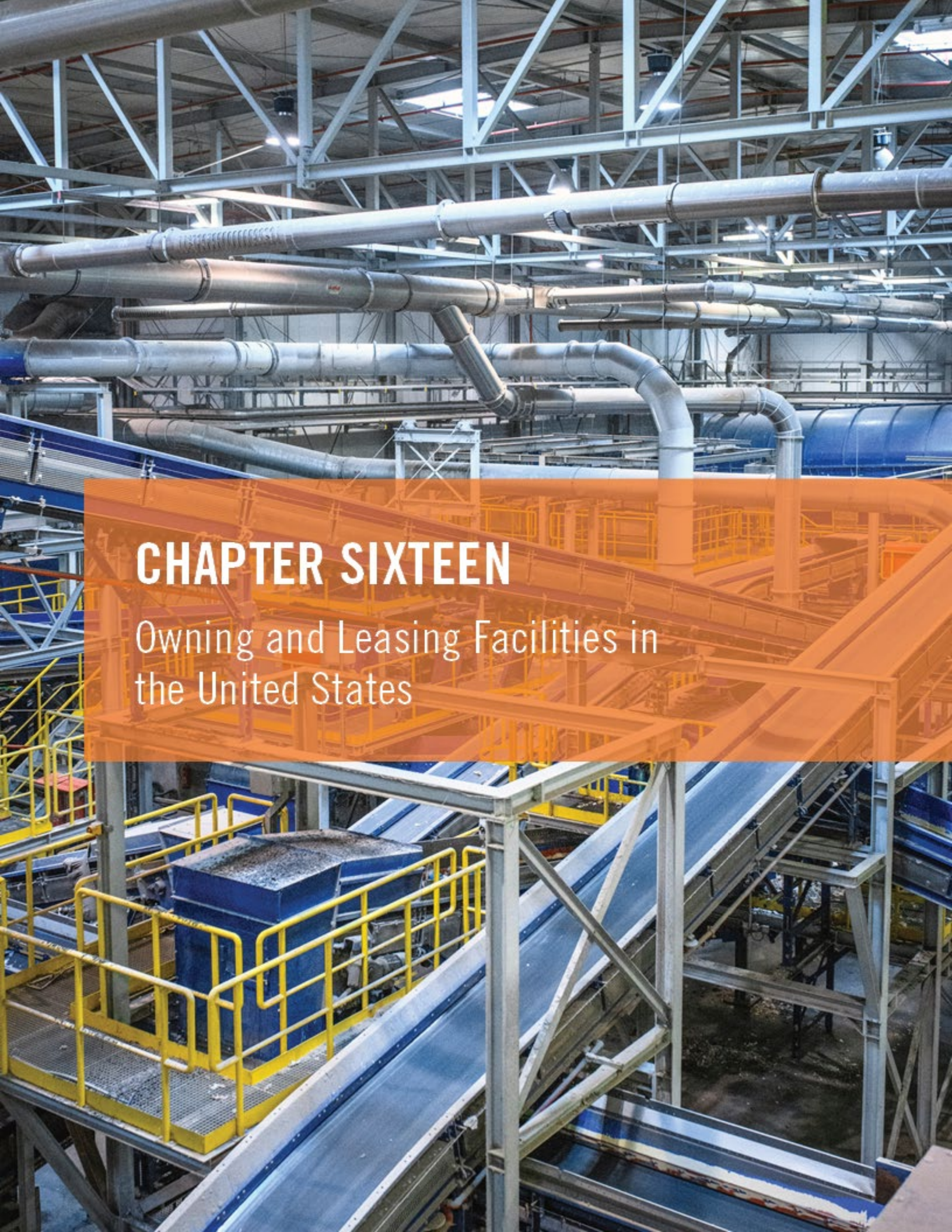
The Clayton Act prohibits stock or asset acquisitions that may substantially lessen competition in any relevant market. The Antitrust Division of the Department of Justice and the Federal Trade Commission have jointly issued merger guidelines that set forth the basis upon which governmental agencies will evaluate the legality of mergers and acquisitions under the antitrust laws. Advance notification to the Federal Trade Commission and the Antitrust Division of mergers and acquisitions may be required where the transaction meets certain threshold requirements of the Hart-Scott-Rodino Antitrust Improvements Act (*see* Chapter 11, *United States Business Acquisitions*).

G. Price Discrimination

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

H. State Laws

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



CHAPTER SIXTEEN

Owning and Leasing Facilities in the United States

Chapter Sixteen -

OWNING AND LEASING FACILITIES IN THE UNITED STATES

A. Introduction

There are many laws in the United States that deal with the ownership, leasing, and use of real property. Some of those laws have particular application to non-US companies (such as the Foreign Investment in Real Property Tax Act, the Agricultural Foreign Investment Disclosure Act of 1978, and certain regulations promulgated by the Committee on Foreign Investment in the United States). Those laws and regulations, and certain environmental and other laws, are discussed below.

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

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

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

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

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

CFIUS is a federal interagency committee with jurisdiction to conduct national security reviews of foreign investments and acquisitions in the United States including transactions that would afford direct or indirect control over certain property assets by foreign persons. Based upon findings during the review, CFIUS may prohibit the transaction or require implementation and maintenance of procedures to mitigate a national security threat.

Pursuant to authority granted under the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), CFIUS may review acquisitions, leases, and concessions that afford certain defined control rights to foreign persons over real estate that is proximate to identified US military and governmental assets or that are in or operate as part of certain major airports and maritime ports. Additionally, under its

broad authority to review foreign control acquisitions and non-control investments in US businesses, CFIUS may consider the national security vulnerability of any property assets acquired through the transaction such as factory and warehouse buildings, other physical structures, and land.

Filings with CFIUS in this context are generally voluntary; however, certain filings may be mandatory, such as an acquisition of a US business that produces, designs, tests, manufactures, fabricates, develops critical technologies, and certain direct and indirect acquisitions by a foreign government. Due to the potential complexities, penalties for failure to submit a mandatory notice, as well as CFIUS's ability to review completed transactions, counsel should be sought regarding CFIUS risk and the advisability of making these filings. For further detail concerning the applicability of CFIUS, *see* Chapter 6, *Regulation of Non-US Companies*, and Chapter 11, *United States Business Acquisitions*.

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

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

E. Environmental Laws

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

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

There are dozens of federal, state, and local statutes governing environmental matters. For a discussion of major federal environmental laws, *see* Chapter 18, *Environmental Laws*.

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

- Moving earth in wetlands areas or with resulting water sedimentation;
- Emitting, discharging, or releasing substances into the air or water;
- Generating hazardous waste;
- Treating, storing, or accepting hazardous waste for disposal;
- Transporting hazardous materials;
- Owning or operating underground storage tanks or pollution control devices;
- Spilling oil or hazardous substances; or
- Owning or operating a facility in critical watershed areas or in the habitat of endangered species.

Since environmental laws can present significant exposure to a company, their application to a particular company should be thoroughly evaluated. Non-US companies should keep in mind the following basic principles when dealing in this area.

- **Environmental laws are very complicated**, consisting of layers of laws, regulations, policies, and guidelines at federal, state, and local levels.
- **Environmental laws are not always fair**, with liability being imposed in some cases regardless of whether a company (or its business) was the active cause of the pollution or contamination.
- **Take environmental laws seriously**, since criminal sanctions or substantial civil penalties can be imposed for their violation.
- **Cheaper is not always better**, money invested in quality assistance pays off since environmental issues are complex and can have significant adverse effects if not properly resolved.
- **Compliance is smart,** since dealing with matters promptly and definitively is the best alternative. Companies are obligated to know the laws and comply with them. Ignoring them can lead to significant costs, disruptions, and potential criminal sanctions.

F. Local Zoning and Land Use Regulation

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

G. State Restrictions on the Foreign Ownership of Real Property

Many states have enacted individual reporting requirements or restrictions affecting the beneficial ownership of land (agricultural or otherwise). As of the date that this chapter was written, 18 states had their own reporting requirements related to the acquisition of real property, and over 30 states had enacted statutory regimes regulating the beneficial ownership (both foreign and corporate) of real property assets. This area of law, both at the state and federal level, is rapidly evolving, and special care should be given when considering such investments in the United States.

CHAPTER SEVENTEEN

Privacy and Data Protection

Chapter Seventeen -

PRIVACY AND DATA PROTECTION

The United States does not have a comprehensive national privacy law or centralized data protection authority. Federal privacy and data protection laws are generally sector- and industry-specific. As a result, Issues of privacy and data protection are generally governed by state law. Many states have enacted comprehensive consumer privacy laws of general applicability. While these state laws share common features, they are not identical, creating a complex compliance landscape. Companies doing business in the United States must comply with all applicable federal and state laws, determined by the company's industry, the type of information involved, the geographic scope of its operations, and the residency of the individuals whose data is collected.

This chapter provides an overview of major federal laws and regulations addressing privacy and data protection, the expanding landscape of state comprehensive privacy laws, and key themes across applicable state laws. The language and interpretation of these laws vary considerably by jurisdiction. This area of law is constantly changing and can result in serious penalties for non-compliance. Companies should seek counsel from a knowledgeable lawyer for creating and implementing privacy and data protection policies and procedures.

A. Federal Laws and Regulations

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

I. Consumer Protection

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

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

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

The FTC has also held that it is an unfair business practice for a company, regardless of its size and revenue, to collect personal or sensitive customer data and not employ adequate security measures to protect that data. The FTC routinely investigates data breaches and brings enforcement actions against companies where they find that breaches were caused by inadequate data security practices or the failure of the companies to abide by their own security policies. FTC enforcement actions have included settlements imposing penalties of up to hundreds of millions of dollars.

When creating and implementing data security policies and procedures, companies doing business in the United States should refer to these enforcement actions, as well as guidance issued by the FTC. The FTC publishes guidance on relevant topics, including building security safeguards into products connected to the Internet of Things, avoiding unauthorized disclosures for businesses buying and selling debt, protecting against cybersecurity attacks, and ensuring that AI systems do not produce discriminatory outcomes.

II. Financial Personal Information

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

The FTC's Safeguards Rule was substantially amended in December 2021, with implementation that occurred in phases. Key requirements include: designation of a qualified individual to oversee information security; written risk assessments with specific criteria for evaluating risks; encryption of all customer information in transit and at rest; multifactor authentication for all access to information systems; and data retention and disposal procedures. These also mandate electronic breach notification to the FTC within 30 days for incidents affecting 500 or more consumers. A small business exception exempts institutions maintaining information on fewer than 5,000 consumers from certain technical requirements.

III. Consumer Credit Reporting Agencies

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

The CFPB and FTC have brought major enforcement actions against credit-reporting agencies. The TransUnion Rental Screening Solutions settlement (October 2023) resulted in $15 million in penalties for accuracy failures in tenant screening reports—the largest tenant screening settlement ever. A separate TransUnion action (October 2023) resulted in $8 million for security freeze and lock failures dating to 2003. The Equifax consent order (January 2025) imposed $15 million for reinvestigation failures, improper reinsertion of deleted information, and selling inaccurate credit scores.

IV. Credit Card Information

In general, the use and storage of credit card information, including digital information, are regulated by the Payment Card Industry Security Standards Council. This is a private trade association that issues detailed data security standards for credit card information called the Payment Card Industry Data Security Standards (PCI DSS). The FTC has brought enforcement actions against businesses that collect payment card information and have failed to comply with PCI DSS. Businesses that are collecting or

processing credit card information are required to use and protect such information in accordance with PCI DSS standards. Further, failure to adhere to those standards constitutes a deceptive trade practice, which can result in enforcement actions and fines by the FTC and state governments.

Key requirements introduced by PCI DSS v4.0 (March 31, 2022) include: increased minimum password length to 12 characters; multi-factor authentication required for all access to cardholder data environments (not just remote access); automated phishing protections; user access reviews at least every six months; automated audit log review mechanisms; and change detection on payment pages. PCI DSS v4.0 also introduces a customized approach compliance validation method allowing organizations to implement innovative controls that meet security objectives through alternative means.

V. Health and Medical Personal Information

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

HIPAA requires Covered Entities to provide individuals with proper notice and consent prior to collecting, processing, and transferring PHI. HIPAA and the HITECH Act also require Covered Entities to take substantive steps to protect PHI in their possession.

To ensure security with respect to sharing PHI with other companies, Covered Entities are required to enter into signed agreements with service providers (Business Associates) prior to providing such Business Associates with access to PHI. These agreements, called Business Associate Agreements or BAAs, require Business Associates to protect PHI by implementing various data security measures, as required by HIPAA and the HITECH Act.

HIPAA is enforced by the United States Department of Health & Human Services Office for Civil Rights (OCR) and includes penalties based on levels of non-compliance. These penalties are adjusted for inflation annually. Violations can also result in criminal charges and jail time.

OCR enforcement activity is robust. Notable settlements include Montefiore Medical Center ($4.75 million, February 2024) for a malicious insider breach, Solara Medical Supplies ($3 million, January 2025) for phishing-related security failures, and Warby Parker ($1.5 million, February 2025) for cybersecurity hacking failures. OCR's Risk Analysis Initiative has specifically targeted security rule risk analysis failures, resulting in multiple enforcement actions against healthcare providers. Key regulatory updates include enhanced confidentiality protections for substance use disorder treatment records and the HIPAA Reproductive Health Information Rule adding new protections for reproductive healthcare information.

VI. Employment-Related Personal Information

In the United States, there is no uniform employee-related personal information law or regulation. However, there are applicable provisions within different industry-specific laws and regulations that address personal information collected by employers. In general, employers can only request medical information when it is relevant to the job in question. The Americans with Disabilities Act (ADA) requires medical information that is obtained from applicants or employees to be maintained separately and kept confidential.

The EEOC issued significant guidance on Wearables in the Workplace (December 19, 2024), clarifying that wearable devices collecting health data may constitute medical examinations under the ADA and its implementing regulations. The guidance establishes that directing employees to provide health

information via wearables may constitute disability-related inquiries subject to the "job-related and consistent with business necessity" standard. Medical data from wearables must be kept confidential and stored separately from personnel files. Other EEOC guidance confirms that reasonable accommodations granted during the COVID-19 pandemic may continue based on individualized assessment, and that long COVID may qualify as an ADA disability requiring accommodation.

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

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

VII. Personal Information of Children

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

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

The FTC finalized significant amendments to the COPPA Rule in January 2025. The final rule expands the definition of personal information to include biometric identifiers and government-issued identifiers, enhances notice requirements, requires publication of data retention policies, and strengthens Safe Harbor program transparency. FTC enforcement of COPPA has produced record penalties, including the Epic Games settlement ($275 million COPPA penalty, 2023), the Amazon/Alexa settlement ($25 million, 2023), and the Microsoft/Xbox settlement ($20 million, 2023).

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

VIII. Student Records

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

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

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

Schools may also release certain information such as a student's name, address, telephone number, date of birth, and dates of attendance (directory information) without consent. However, a school must provide a parent or eligible student with the option to opt out of the release of the student's directory information. Department of Education guidance addresses requirements that apply to student health records, school resource officer disclosures, and EdTech data practices.

B. State Laws and Regulations

Every state has laws concerning the collection, use, and disclosure of personal information, and each state law varies in scope, application, requirements, and enforcement. Even the definition and scope of personal information vary among the states' laws. This section provides an overview of the laws generally adopted by the states and highlights specific state laws that regulate the privacy and security of personal information.

I. Privacy Policies

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

II. State Deceptive Trade Practice Laws

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

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

III. Comprehensive State Consumer Privacy Laws

Unlike sector-specific federal laws such as HIPAA or GLBA, many states have enacted consumer privacy laws that apply generally across industries to businesses meeting specified thresholds. These establish broad rights for consumers and obligations for businesses processing personal data. While each law has unique characteristics, most follow a common framework establishing consumer rights to access, correct, delete, and port their data, as well as rights to opt out of certain processing activities.

IV. The California Consumer Privacy Act and California Privacy Rights Act

California enacted the California Consumer Privacy Act of 2018 (CCPA), which became effective January 1, 2020. The California Privacy Rights Act (CPRA) substantially amended the CCPA and became operative January 1, 2023, with enforcement beginning July 1, 2023. The combined law imposes substantial requirements and restrictions on the collection, use, and disclosure of personal information of California residents by for-profit businesses. The CCPA/CPRA defines personal information extremely broadly as "information that identifies, relates to, describes, is capable of being associated with, or could reasonably be linked, directly or indirectly, with a particular consumer or household."

Key requirements include:

- At or before collection of personal information, consumers must be notified of the categories of personal information being collected and the purposes for which the business will use such personal information;
- The business is required to have a privacy policy that discloses the categories of personal information sold or shared in the prior 12 months; the purposes for which the business collects, uses, sells, and shares personal information; the categories and sources from which the business collects personal information; the categories of third parties to whom the business discloses personal information; and the rights afforded to consumers;
- A "Do Not Sell or Share My Personal Information" link on the business's website and a mechanism for consumers to opt out of the sale or sharing of their personal information;
- Consumer rights to access, correct, and delete personal information, as well as to limit use of sensitive personal information;
- Consumers have a right to not be discriminated against for exercising their rights; and
- Consumers have a private right of action for certain data breaches that result from violations of a business's duty to implement and maintain reasonable security practices.

The CPRA established the California Privacy Protection Agency (CPPA), the first dedicated state privacy regulator in the United States. The CPPA has issued comprehensive regulations and has begun active enforcement. Notable enforcement actions include Sephora ($1.2 million, August 2022) for failing to honor Global Privacy Control opt-out signals, Honda ($632,500, March 2025), and Tractor Supply ($1.35 million, September 2025)—the largest CPPA fine and first employment data case. The CPPA also finalized regulations on automated decision-making technology (ADMT), requiring pre-use notice, opt-out rights, and appeal mechanisms for automated decisions affecting employment, insurance, education, housing, and similar significant decisions.

The CCPA/CPRA applies to for-profit businesses that collect and control California residents' personal information, do business in California, and meet one of these thresholds: annual gross revenues exceeding $25 million; receiving, selling, or sharing the personal information of 100,000 or more California residents, households, or devices annually (increased from 50,000 under CPRA); or deriving 50% or more of annual revenues from selling or sharing California residents' personal information.

V. Virginia Consumer Data Protection Act

Virginia enacted the Consumer Data Protection Act (CDPA), effective January 1, 2023. The CDPA applies to businesses conducting business in Virginia or targeting Virginia residents that control or process personal data of at least 100,000 Virginia consumers, or control or process data of at least 25,000 consumers and derive over 50% of gross revenue from personal data sales. The law provides consumer rights similar to California but is generally considered more business-friendly, with a permanent 30-day cure period and state-only enforcement (no private right of action by individuals).

VI. Colorado Privacy Act

Colorado enacted the Colorado Privacy Act (CPA), effective July 1, 2023. Colorado's law is notable for applying to nonprofit organizations and for requiring recognition of universal opt-out mechanisms. Amendments effective July 1, 2025 add biometric provisions similar to those discussed below with respect to Illinois, including written policy requirements, notice and consent obligations, and employee coverage, with penalties up to $20,000 per violation.

VII. Connecticut Data Privacy Act

Connecticut enacted the Connecticut Data Privacy Act (CTDPA), effective July 1, 2023. The CTDPA includes consumer-friendly provisions such as a prohibition on geofencing around health facilities, consumer health data provisions, enhanced protections for minors, and mandatory recognition of universal opt-out mechanisms.

VIII. Other Comprehensive State Privacy Laws

Additional states have enacted comprehensive privacy laws with varying effective dates:

- Utah Consumer Privacy Act: Effective December 31, 2023. Most business-friendly law, requiring both $25 million revenue AND processing thresholds.
- Texas Data Privacy and Security Act: Effective July 1, 2024. Uses SBA small business exemption instead of numerical thresholds.
- Oregon Consumer Privacy Act: Effective July 1, 2024 (nonprofits July 1, 2025). Unique right to request list of specific third parties receiving data.
- Montana Consumer Data Privacy Act: Effective October 1, 2024. Lowest thresholds (50,000 consumers) given state population.
- Delaware Personal Data Privacy Act: Effective January 1, 2025. Applies to nonprofits with lower thresholds.
- Iowa Consumer Data Protection Act: Effective January 1, 2025. 90-day cure period (longest of any state).
- New Jersey Data Protection Act: Effective January 15, 2025. Broadest sensitive data definition.
- New Hampshire Data Privacy Act: Effective January 1, 2025.
- Nebraska Data Privacy Act: Effective January 1, 2025.
- Tennessee Information Protection Act: Effective July 1, 2025. Unique NIST Privacy Framework affirmative defense.
- Maryland Online Data Privacy Act: Effective October 1, 2025. Most consumer-protective law with strict data minimization and prohibition on sensitive data sales.
- Minnesota Consumer Data Privacy Act: Effective July 31, 2025.
- Indiana Consumer Data Protection Act: Effective January 1, 2026.
- Kentucky Consumer Data Protection Act: Effective January 1, 2026.
- Rhode Island Data Transparency and Privacy Protection Act: Effective January 1, 2026.

IX. State Breach Notification Laws

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

State security breach laws generally include the following provisions:

- Who is required to comply (e.g., businesses, government entities, data or information brokers);

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

Multiple states adopted stricter notification requirements in 2024-2025. California now requires 30-day notification to consumers and 15-day state notification for breaches affecting 500 or more residents. New York now requires 30-day notification and added medical and health insurance information to the personal information definition. Florida added biometric, genetic, and geolocation information to its personal information definition. Texas shortened its state notification deadline from 60 to 30 days.

X. Biometric Information

States have increased protections for biometric information either through stand-alone legislation or by expanding the scope of the definition of personal information under existing privacy laws. The biometric information covered by these laws varies.

Under the California CCPA/CPRA, biometric information is broadly defined to mean an individual's physiological, biological, or behavioral characteristics that can be used, singly or in combination with each other or with other identifying data, to establish individual identity. Biometric information includes imagery of the iris, retina, fingerprint, face, hand, palm, vein patterns, and voice recordings from which an identifier template, such as a faceprint, a minutiae template, or a voiceprint, can be extracted, and keystroke patterns or rhythms, gait patterns or rhythms, and sleep, health, or exercise data that contain identifying information.

The Illinois Biometric Information Privacy Act (BIPA) remains the most significant biometric privacy law due to its private right of action and statutory damages provisions. BIPA requires businesses to: (i) provide written notice that a biometric identifier or biometric information is being collected or stored; (ii) provide written notice about the specific purpose and duration for which biometric information is being collected, stored, and used; and (iii) obtain a signed written release from the individual. BIPA also prohibits selling, leasing, trading, or otherwise profiting from biometric information and requires businesses to protect biometric information using reasonable security measures.

Major BIPA settlements include Rogers v. BNSF Railway ($75 million, final approval June 2024) and Clearview AI ($51.75 million in company equity, March 2025). Texas enforcement under its biometric law (CUBI) produced a landmark $1.4 billion settlement with Meta/Facebook (July 2024)—the largest privacy settlement by a single state—for the Tag Suggestions facial geometry feature. Texas amendments clarify that CUBI applies to AI systems using biometric data. Colorado CPA biometric amendments add BIPA-style provisions, including employee coverage.

XI. Location Information

Where applicable, location information has traditionally been included within the definition of personal information in federal and state regulations. FTC enforcement actions in 2024 against data brokers X-Mode Social/Outlogic and InMarket Media marked the first-ever prohibitions on selling sensitive location data, requiring deletion of previously collected data and derived products. Many state comprehensive privacy laws now classify precise geolocation data as sensitive personal information requiring opt-in consent or providing enhanced opt-out rights.

XII. Artificial Intelligence and Automated Decision-Making

The Rite Aid order (December 2023) represented the first FTC enforcement alleging AI discrimination as an unfair practice, after the company's facial recognition technology disproportionately flagged people of color.

States and localities have begun regulating the use of artificial intelligence and automated decision-making technology, particularly in employment and insurance contexts.

The Colorado AI Act, with an effective date now delayed to June 30, 2026, imposes duties on developers and deployers of high-risk AI systems making consequential decisions affecting employment, education, financial services, housing, insurance, healthcare, and government services. Developers must provide documentation and disclose discovered algorithmic discrimination to the state within 90 days. Deployers must implement risk management programs, complete annual impact assessments, and provide consumer notice and appeal rights. Compliance with the NIST AI Risk Management Framework creates a rebuttable presumption of reasonable care.

New York City Local Law 144 requires bias audits by independent auditors for automated employment decision tools (AEDTs) used in hiring and promotion decisions. Employers must calculate selection rates and impact ratios by sex and race/ethnicity, publish audit summaries on their websites, and provide notice to candidates at least 10 business days before using an AEDT.

Illinois has enacted multiple AI employment laws. The AI Video Interview Act requires notice, explanation, and consent before AI video interview analysis. Illinois has also amended the Illinois Human Rights Act to prohibit AI that results in discrimination, require notice to employees and applicants, and prohibit using ZIP codes as proxies for protected classes.

California's CPPA finalized regulations on automated decision-making technology, requiring pre-use notice, opt-out rights, and access to information about the logic involved when automated decision-making technology is used to make significant decisions. Colorado requires insurers to demonstrate how they test algorithms to prevent unfair discrimination.

C. Electronic Marketing Practices

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

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

the times during which such telemarketing calls can be made, and require the business using telemarketing to maintain records and allow consumers to opt out.

- **AI-generated voices.** The FCC issued a significant ruling in February 2024 confirming that AI-generated voices qualify as artificial or prerecorded voice under the Telephone Consumer Protection Act (TCPA), requiring prior express consent. The FCC imposed a US$6 million penalty in September 2024 for AI-generated Biden-impersonation robocalls targeting New Hampshire voters. A separate FCC order (February 2024) requires callers to honor consent revocation requests within 10 business days through any reasonable method. TCPA class actions increased approximately 95% in 2025.

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

The period from 2020 to 2026 represents the most significant transformation of US privacy law since the enactment of HIPAA and GLBA. Many states have enacted comprehensive consumer privacy laws, with Maryland's strict data minimization requirements representing the newest frontier in state privacy regulation. This proliferation of state laws has created compliance complexity for businesses operating across multiple jurisdictions.

At the federal level, comprehensive privacy legislation has repeatedly failed to advance despite bipartisan interest.

The emergence of artificial intelligence has created new privacy challenges that existing frameworks were not designed to address. State AI laws, led by Colorado's comprehensive AI Act, New York City Local Law 144, and California's ADMT regulations, preview what will become an increasingly regulated landscape for algorithmic decision-making. The FTC has signaled that it will use its existing statutory authority to address AI-related harms, including algorithmic discrimination and deceptive AI claims.

Biometric privacy litigation, particularly under Illinois BIPA, as well as state enforcement, continue to drive significant settlements and reshape data practices nationally.

Organizations must now maintain multijurisdictional compliance programs addressing not just traditional privacy and security requirements, but also biometric consent, algorithmic impact assessment, children's data minimization, and automated decision-making transparency obligations. Companies should regularly review their data practices, update privacy policies, implement robust consent mechanisms, and monitor the evolving legal landscape across all jurisdictions in which they operate.

CHAPTER EIGHTEEN

Environmental Law

Chapter Eighteen -

ENVIRONMENTAL LAW

When establishing or acquiring a business in the United States, a non-US company should become familiar with the complex environmental laws and requirements that apply to its operations, as well as the potential liabilities for any pollution associated with those operations. Environmental liability can arise from governmental enforcement of environmental statutes, regulations or ordinances, or from common law claims by third parties, and may result in penalties or a requirement to clean up contamination.

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

Generally, most environmental enforcement occurs at the federal level and state level. At the federal level, the Environmental Protection Agency (EPA) is the largest and most important agency charged with administering environmental laws. Traditional enforcement activities focus on whether a regulated entity has obtained and is in compliance with all required permits and is in compliance with all other statutory and regulatory requirements. Most commonly, EPA resolves cases through informal methods, such as by sending a warning letter or notice of violation, or through administrative complaints and penalty orders. In some cases, judicial enforcement is pursued: the EPA refers several hundred cases per year to the Department of Justice for civil enforcement and a smaller number of cases for criminal prosecution.

State agencies are important partners in environmental enforcement, particularly where a state has been delegated authority or authorized to implement a program under a federal environmental statute. However, states have their own statutory and regulatory programs as well. When doing business in the United States, it is important to understand not just the applicable federal laws, but also the laws of each state in which the company has a facility or other operations.

While most enforcement occurs at the federal or state level, there may be environmental requirements adopted by cities, counties, or other municipal or quasi-municipal bodies, e.g., water districts. These also could result in penalties for failure to comply.

Many federal environmental statutes contain citizen suit provisions authorizing actions that supplement governmental enforcement.

As noted above, the EPA predominates at the federal level, playing a key role in ensuring compliance with environmental regulatory programs. However, other federal agencies are also involved in the administration or enforcement of environmental laws, including the following:

- The US Army Corps of Engineers, which is tasked with enforcement of Section 404 of the Clean Water Act, which law for the most part addresses potential water contamination during construction;
- The Federal Energy Regulatory Commission (FERC), which regulates the transmission and wholesale sale of electricity and natural gas in interstate commerce and regulates the transportation of oil by pipeline in interstate commerce; and
- The US Department of Interior, Fish & Wildlife Service, which manages the protection of fish, wildlife, plants, and their habitats.

There are also federally created or authorized bodies that function at a regional level to ensure compliance with environmental requirements across state borders. These types of entities include River Basin Commissions, which operate pursuant to multistate agreements or compacts approved by Congress and which manage water resources within a particular river basin.

The discussion below identifies the major federal environmental laws in the areas of (a) natural resource protection, (b) chemicals and wastes, and (c) pollution control. Additionally, section (d) discusses considerations relating to common law claims.

Note that the listing below is not intended to be comprehensive and, in particular, does not include any state laws, multistate compacts or similar arrangements, or county or municipal requirements.

A. Natural Resource Laws

Below are the major US federal laws dealing with protection of natural resources.

Federal Law (common name)	Summary	Coverage
National Environmental Protection Act of 1969 (NEPA) 42 U.S.C. § 14321	Compels agencies to establish criteria and identification of three classes of actions: those that require preparation of an environmental impact statement; those that require preparation of an environmental assessment; and those categorically excluded from further NEPA review.	Applies to every federal agency and department.
Endangered Species Act of 1973 (ESA) 16 U.S.C. ch. 35 § 1531	Prohibits the taking of any animal species federally designated as endangered and prohibits the removal or destruction of listed plants on federal property. Prohibits the taking of listed plants on private property in knowing violation of any law or regulation of any state or in the course of any violation of a state criminal trespass law.	Applies to everyone: private citizens, public entities, and business entities—both international and domestic.
Migratory Bird Treaty Act of 1918 16 U.S.C. §§ 703-712	Unless authorized by waiver, prohibits hunting or taking of migratory birds, including dead birds and bird parts such as feathers and nests.	Applies to everyone: private citizens, public entities, and business entities—both international and domestic.
Bald and Golden Eagle Protection Act of 1940 16 U.S.C. § 668	Unless authorized by permit, prohibits taking of bald eagles and golden eagles, including eagle parts such as feathers and nests.	Applies to everyone: private citizens, public entities, and business entities - both international and domestic.

B. Chemical and Waste Laws

Below are the major federal laws regulating chemicals and wastes.

Federal Law (common name)	Summary	Coverage
Comprehensive Environmental Response Compensation and Liability Act of 1980 (CERCLA or Superfund) 42 U.S.C. § 9601	Provides criteria for the investigation of and remediation of sites contaminated with hazardous substances. Provides criteria for identifying parties liable for release of those substances. Imposes strict liability for improper disposal of hazardous waste.	CERCLA assigns potential liability for release of hazardous substances to: current owner/operator; past owner/operator at time of substance release; party who arranged for disposal of hazardous substance at the site; and party who transported a hazardous substance to the site.
The Emergency Planning and Community Right-to-Know Act of 1986 (EPCRA) 42 U.S.C. §§ 11001-11003	Requires facilities to report the amount, location, and storage conditions of hazardous chemicals and mixtures containing hazardous chemicals present at facilities.	Any facility that is required by the Occupational Safety and Health Administration (OSHA) under its Hazard Communication Standard to prepare or have available a Safety Data Sheet (SDS) for a hazardous chemical or that has on-site, for any one day in a calendar year, an amount of a hazardous chemical equal to or greater than: (1) 10,000 pounds (4,500 kg) for hazardous chemicals; or (2) lesser of 500 pounds (230 kg) or the threshold planning quantity for extremely hazardous substances.
Federal Insecticide, Fungicide, and Rodenticide Act (FIFRA) 7 U.S.C. ch. 6 § 136	Requires testing and registration of pesticides. Governs distribution, sale, and use of pesticides in the United States. Requires completion of a Notice of Arrival for pesticides imported into the United States.	Manufacturers and distributors of pesticides intended for use in agriculture.
Toxic Substances Control Act of 1976 (TSCA) 15 U.S.C. ch. 53 §§ 2601-2629	Requires reporting, record-keeping, and testing of certain chemicals including polychlorinated biphenyls (PCBs), asbestos, radon and lead-based paint.	Persons or entities who manufacture, import, process, and/or distribute chemical substances in commerce.
Resource Conservation and	Provides standards for the treatment, storage and disposal of hazardous waste. Governs management of	Hazardous waste generators, transporters, and treatment, storage and disposal facilities; landfills and

Federal Law (common name)	Summary	Coverage
Recovery Act (RCRA) 42 U.S.C. ch. 82 §6901	municipal and industrial waste as well as underground storage tanks.	other waste disposal facilities; and owners and operators of underground storage tanks storing petroleum or listed hazardous substances.
Hazardous Materials Transportation Act 49 U.S.C. §§ 5101-5127	Requires hazardous material carriers to classify, package, and label materials appropriately, use specific hazardous material placards for shipments, and have suitable shipping papers at all times. Also requires carriers to maintain rapid response plans for emergencies and undergo safety training programs.	Any person who transports hazardous materials in commerce or is involved in the preparation of the transportation of hazardous materials.

C. Pollution Control Laws

Below are the major US federal laws regulating pollution control.

Federal Law (common name)	Summary	Coverage
Clean Air Act (CAA) 42 U.S.C. §§ 7401-7671	Provides for federal regulation of pollutants under which the EPA has set air quality standards for particulate matter, ozone, sulfur dioxide, nitrogen dioxide, carbon monoxide, and lead. Requires power plants and factories that are sources of a regulated pollutant to use the best available technology.	Companies or industrial facilities that release regulated air pollutants (ozone; carbon monoxide; particulate matter; lead; sulfur dioxide; and nitrogen dioxide) as well as facilities that release hazardous air pollutants.
Clean Water Act (CWA) 33 U.S.C. §§ 1251-1387	Prohibits the discharge of pollutants to surface waters without a permit through the National Pollutant Discharge Elimination System (NPDES).	Industrial facilities, mining, shipping activities, oil and gas extraction; service industries; municipal governments (including sewage treatment plants); and certain agricultural facilities such as animal feedlots.
Oil Pollution Act of 1990 (OPA) 33 U.S.C. ch. 40 § 2701	Requires federal facilities to prepare Facility Response Plans containing contingency oil spill mitigation measures.	Federal facilities storing or handling petroleum; fuel oil; oil mixed with waste; as well as facilities transferring oil by motor vehicle. OPA contains no citizen enforcement provisions but individual employees of federal

Federal Law (common name)	Summary	Coverage
		facilities may face criminal sanctions for OPA violations.
Safe Drinking Water Act (SDWA) 42 U.S.C. § 300f	Requires the EPA to establish National Primary Drinking Water Regulations for contaminants that may cause adverse public health effects. Under the regulations, public water systems must monitor their water for contaminants and ensure compliance with maximum contaminant levels.	All states, localities and public water suppliers, but not including private wells or bottled water.

D. Common Law Enforcement

There are a variety of causes of action pursuant to common law tort doctrines that often are used to redress environmental concerns. These include nuisance, trespass and negligence.

US common law recognizes two distinct but related causes of action for nuisance: private nuisance and public nuisance. In the case of a company doing business in the United States, a private nuisance action might be brought by a third party alleging that the company's operations are causing an unreasonable and substantial interference with the third party's use and enjoyment of their land. Liability for a private nuisance can result from acts that are either: (a) intentional and unreasonable or (b) unintentional but otherwise actionable under the rules controlling liability for negligent or reckless conduct, or abnormally dangerous conditions or activities. In contrast, a public nuisance is an unreasonable interference with the interest of the community or the rights of the general public. Generally, public nuisance actions can be brought only by public authorities, or by a private citizen who has suffered injury different in kind from that suffered by the general public. Further, federal pollution laws (and their state analogues) impose substantive standards on operations that may create a right to a nuisance claim. Violation of a statutory or regulatory standard may be a nuisance per se, automatically subjecting the violator to common law liability in addition to whatever consequences are imposed by statute.

Whereas nuisance protects the right to use and enjoyment of land, trespass protects the right to exclusive possession. A knowing physical invasion of land without the possessor's permission is a trespass. The trespasser is liable for actual damages done or, if there is no actual harm, for nominal damages. Trespass and nuisance may overlap in environmental pollution cases. For example, a group of landowners may sue in both trespass and nuisance for damages to their property caused by microscopic airborne particles from a nearby copper smelter.

Negligence also informs environmental common law and is substantially broader than nuisance. Conduct is negligent if it creates an unreasonable risk of harm to others. A cause of action based on negligence has four elements that must be established:

- A legal duty owed by the defendant to the plaintiff;
- A breach of that duty;
- Harm; and

- A causal relationship between the breach and the harm.

In the environmental area, an example might be an allegation for damages related to contamination caused by the negligent operations of a company.

Toxic torts are personal injury actions based on exposure to substances that present an unusually high risk to human health or the environment. Toxic tort actions arise in a variety of contexts, including occupational and environmental exposure. To prevail, plaintiffs must show:

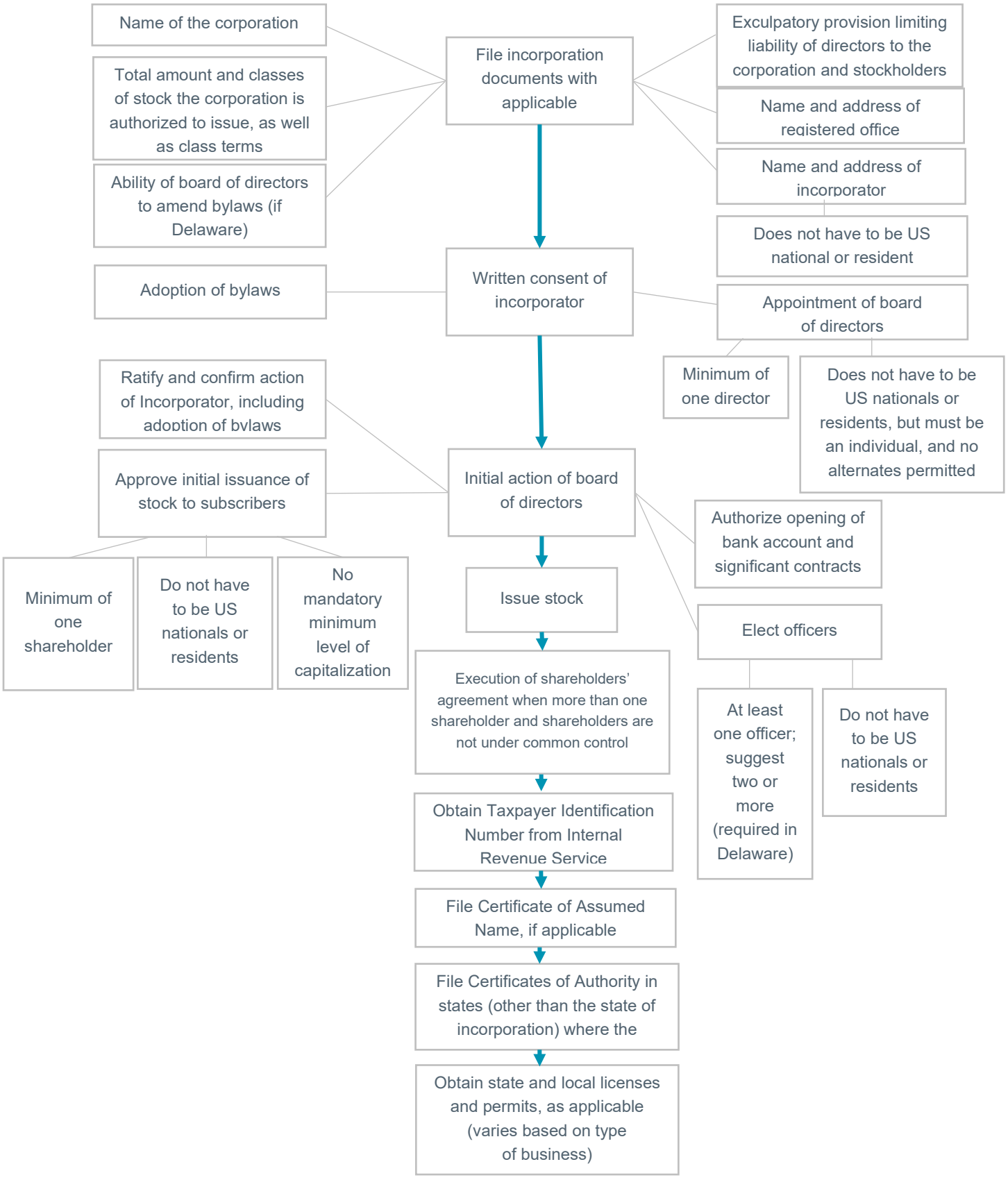
- That they were exposed to chemicals released by the defendants;
- That those chemicals can cause the types of harm they suffered; and
- That the chemicals in fact did cause their harm.

Regarding the first element, plaintiffs can prove fault in toxic tort claims in several ways, including negligence, product liability, and strict liability for ultra-hazardous activity such as transporting dangerous chemicals.

ATTACHMENTS

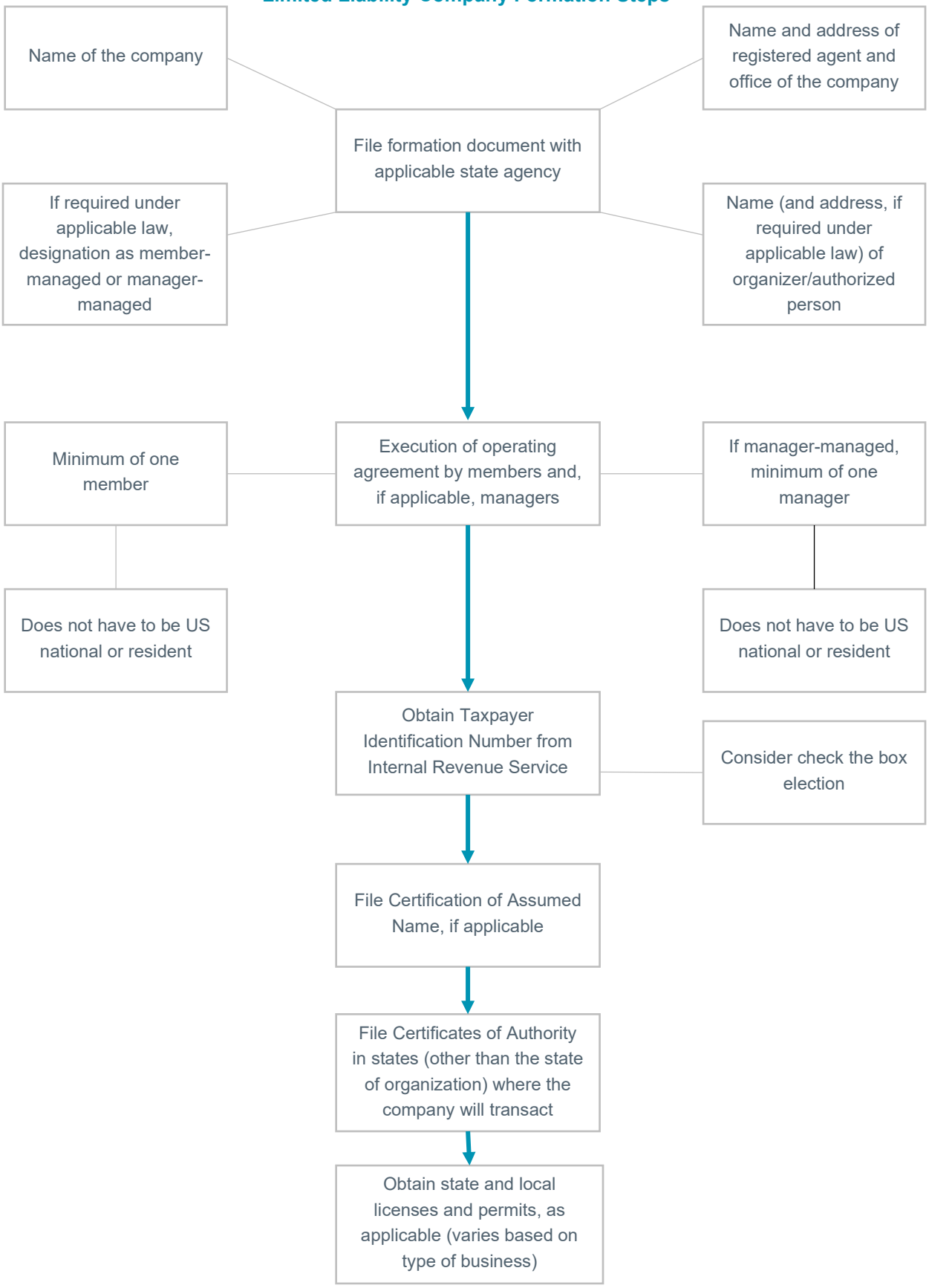
ATTACHMENT 1
Corporation and Limited Liability Company Formation Steps

Corporation Formation Steps



ATTACHMENT 1
Corporation and Limited Liability Company Formation Steps

Limited Liability Company Formation Steps



ATTACHMENT 2

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

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

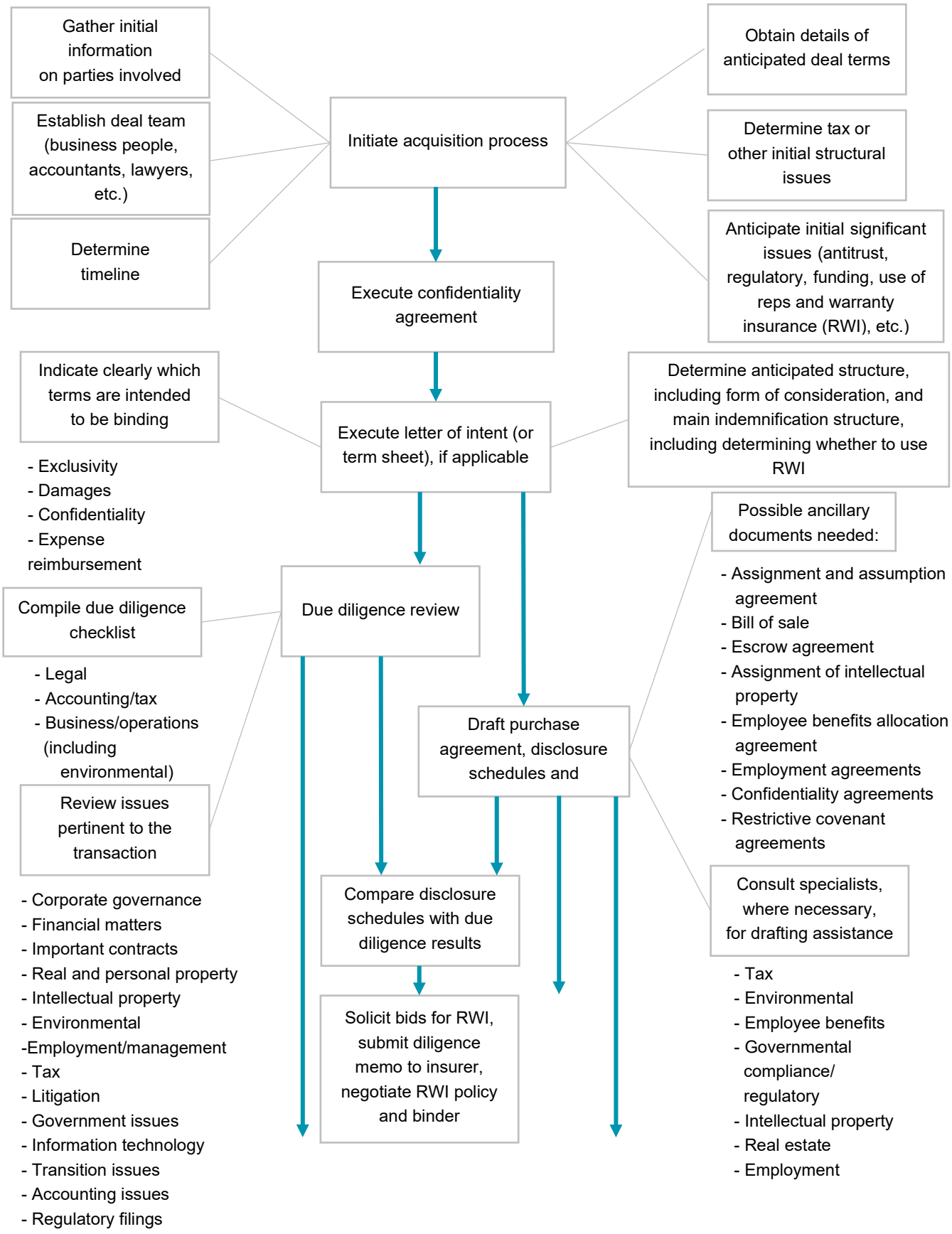
ATTACHMENT 3

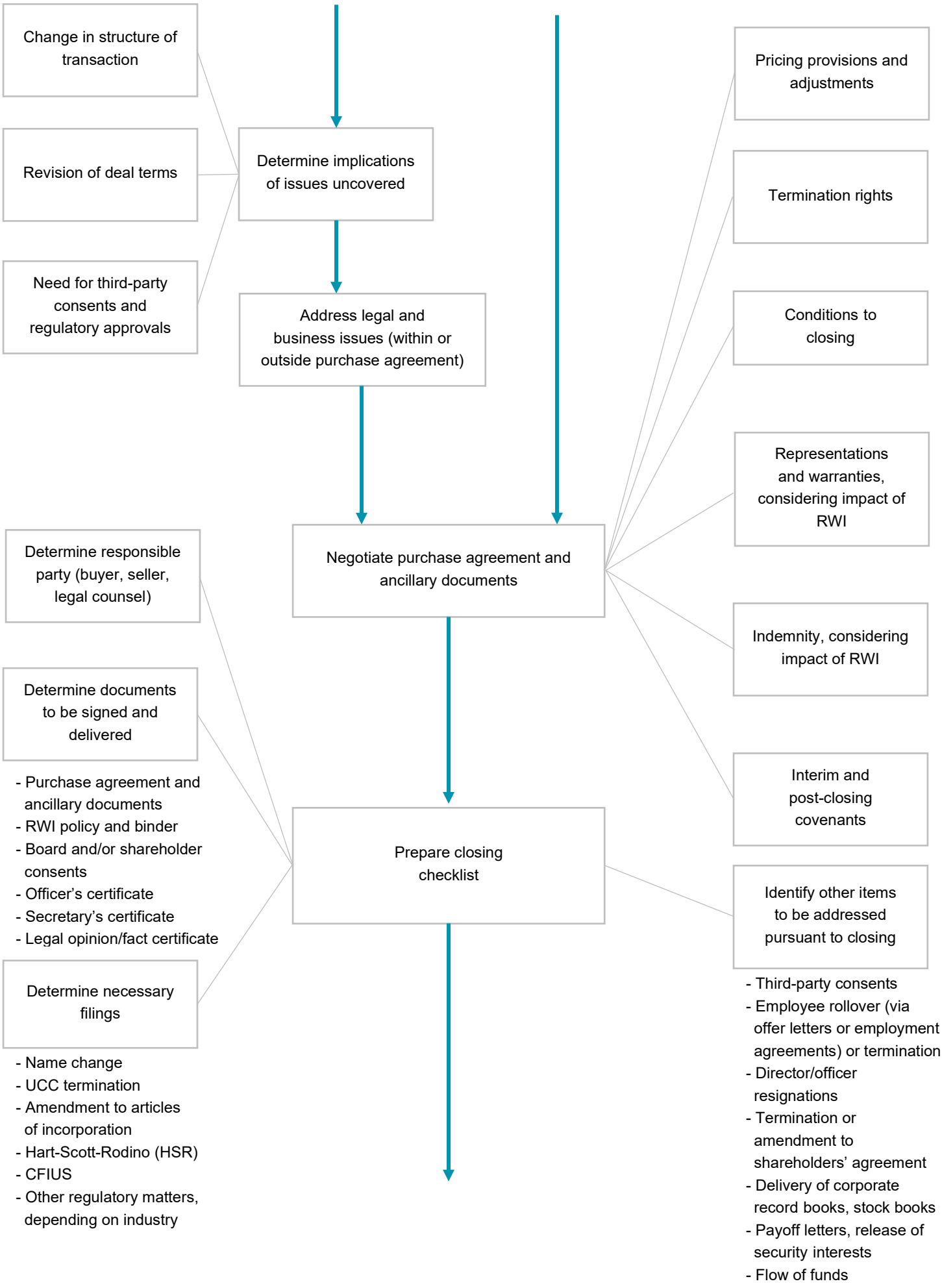
Parties to the New York Convention

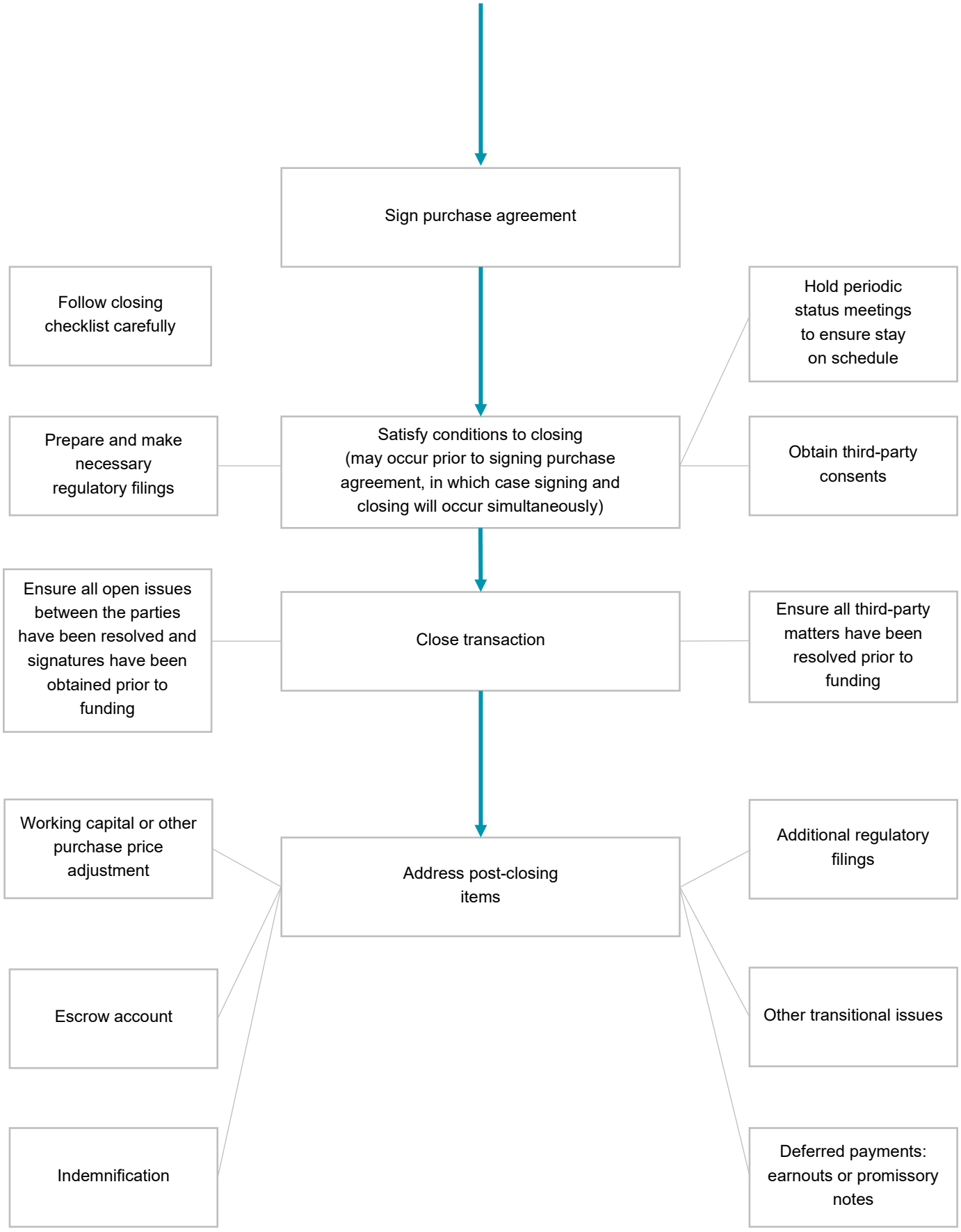
Afghanistan	Czech Republic	Lebanon	Romania
Albania	Democratic Republic of Congo	Lesotho	Russian Federation
Algeria	Denmark	Liberia	Rwanda
Andorra	Djibouti	Liechtenstein	San Marino
Angola	Dominica	Lithuania	Sao Tome and Principe
Antigua and Barbuda	Dominican Republic	Luxembourg	Saudi Arabia
Argentina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

ATTACHMENT 4

US Business Acquisition Steps Flow Chart




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


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

CONTRIBUTORS

CONTRIBUTORS

Editor

Remsen Kinne
Partner
San Francisco
+1.415.882.8019
remsen.kinne@klgates.com

Authors

Sheila A. Armstrong
Partner
Dallas
+1.214.939.4960
sheila.armstrong@klgates.com

Olivia Byrne
Partner
Washington, DC
+1.202.778.9412
olivia.byrne@klgates.com

Leah S. Baucom
Partner
Charlotte
+1.704.331.7502
leah.baucom@klgates.com

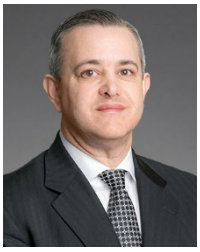
John W. Carlson
Partner
Seattle
+1.206.370.5750
johnny.carlson@klgates.com

Corey Bieber
Partner
Chicago
+1.312.807.4390
corey.bieber@klgates.com

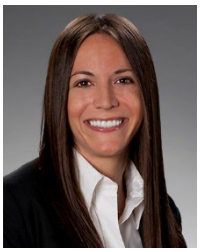
Randy J. Clark
Partner
Charlotte
+1.704.331.7466
randy.clark@klgates.com

Christopher A. Bloom
Of Counsel
Chicago
+1.312.807.4307
christopher.bloom@klgates.com

Lauren Norris Donahue
Partner
Chicago
+1.312.807.4218
lauren.donahue@klgates.com



Eric N. Feldman
Partner
Wilmington
+1.302.416.7077
eric.feldman@klgates.com



Mackenzie M. Powers
Partner
Raleigh
+1.919.743.7315
mackenzie.powers@klgates.com

Brian Graham
Partner
Austin
+1.512.482.6828
brian.graham@klgates.com

Patrick J. Rogers
Partner
Charlotte
+1.704.331.5712
patrick.rogers@klgates.com

Steven F. Hill
Partner
Washington, DC
+1.202.778.9384
steven.hill@klgates.com

Kelly A. Terribile
Partner
Wilmington
+1.302.416.7036
kelly.terribile@klgates.com

Mark G. Knedeisen
Partner
Pittsburgh
+1.412.355.6342
mark.knedeisen@klgates.com

Jeffrey C. Thomson
Associate
Seattle
+1.206.370.7829
jeffrey.thomson@klgates.com

Sam Megally
Partner
Dallas
+1.214.939.5491
sam.megally@klgates.com

Leann M. Walsh
Partner
Raleigh
+1.919.743.7319
leann.walsh@klgates.com

Vishal Mehta
Partner
Washington, DC
+1.202.778.9115
vishal.mehta@klgates.com

Craig P. Wilson
Managing Partner
Harrisburg
+1.717.231.4509
craig.wilson@klgates.com

K&L Gates is a fully integrated global law firm. For more information about K&L Gates or its locations, practices, and registrations, visit klgates.com.

REQ8910