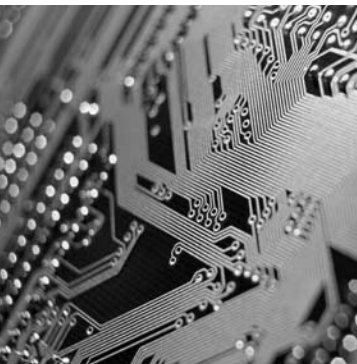
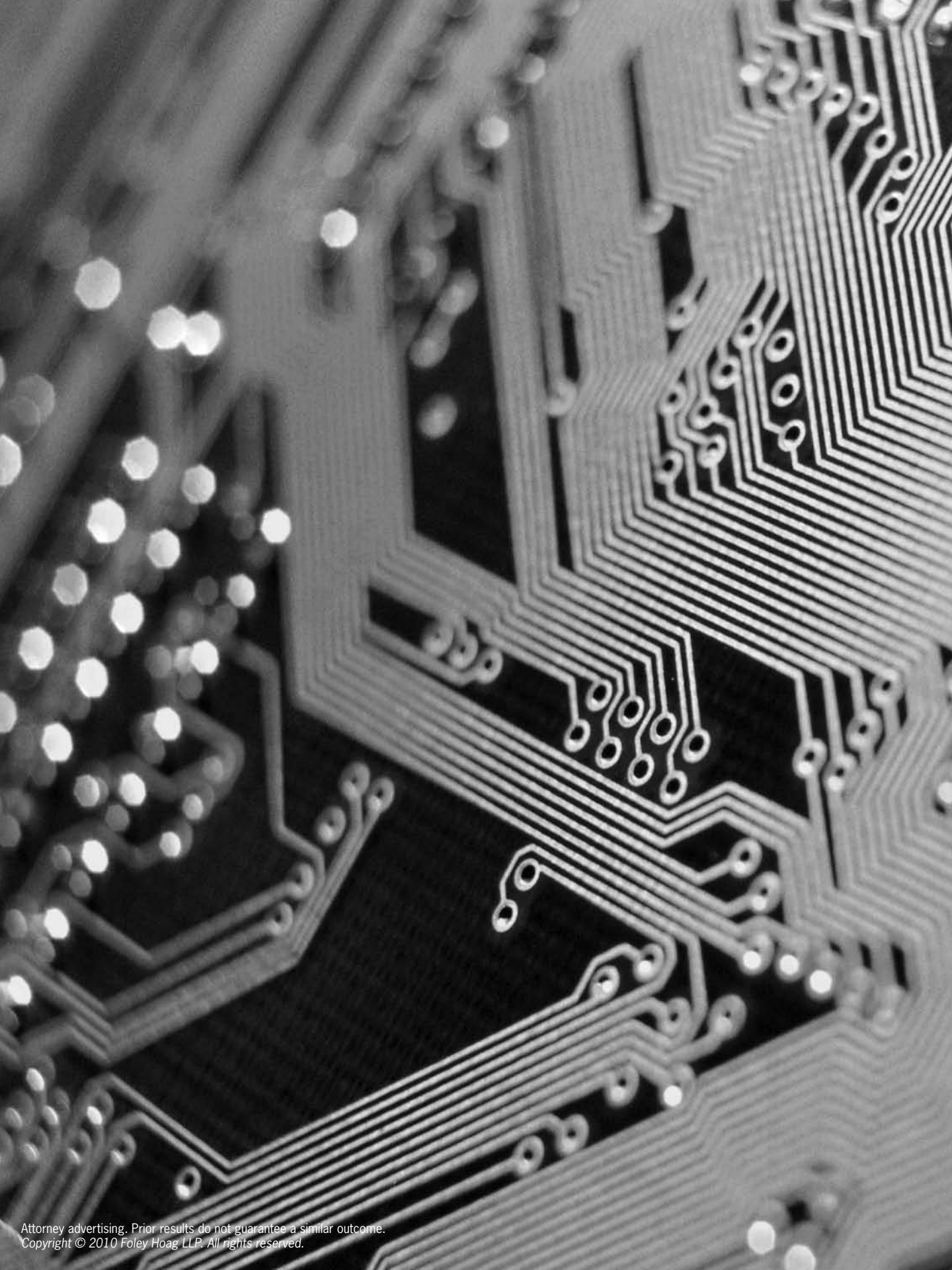


Doing Business in the United States

A Guide to U.S. Law
for Non-U.S. Businesses





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“The laws whose effects are described in this guide are subject to interpretation by courts, may be affected or preempted by federal statutes or regulations, and may themselves be amended or repealed. Particular businesses or industries may also be subject to legal requirements not referred to in this guide.”

Doing Business in the United States

A Guide to U.S. Law for Non-U.S. Businesses

This guide is intended to provide foreign businesspeople with an introduction to the basic kinds of laws and regulations that affect the conduct of business in the United States. The level of detail is varied, reflecting the nature of the legal areas discussed. For example, environmental law and taxation are subjects of detailed and technical regulation, while labor relations are governed as much by custom and practice as by direct regulation. The discussion under each heading is intended to provide only general guidance and is not an exhaustive description of all provisions of federal, state and local law with which a non-U.S. business operating in the U.S. might be required to comply. The laws whose effects are described in this guide are subject to interpretation by courts, may be affected or preempted by federal statutes or regulations, and may themselves be amended or repealed. Particular businesses or industries may also be subject to legal requirements not referred to in this guide. For this reason, you should not rely solely upon this guide when planning the details of a specific transaction or undertaking. Instead, the pertinent details of any transaction or business should be reviewed thoroughly by qualified legal counsel. This guide is intended to outline issues that you may need to address with your legal counsel.

The Federal System (Levels of Government)

The laws and regulations affecting the conduct of business in the United States discussed below flow from sources at three basic levels: federal, state and municipal.

Federal Law

Federal law derives from the United States Constitution and from statutes enacted by the United States Congress and approved by the president. Federal law usually applies everywhere in the United States and prevails over conflicting state or municipal law (but federal and state laws governing the same subject often coexist without conflict, and in those cases both laws may apply).

Most federal statutes are enforced by one or more administrative agencies, which often have authority to adopt regulations that interpret or even expand on the underlying statutes. For example, the federal laws governing public offerings of securities and tender offers for control of publicly held companies are administered by the Securities and Exchange Commission. In some areas, such as defining fraudulent and deceptive practices in the sale of securities, the statutes leave the definitions entirely to the regulations of that commission. Other important federal agencies are referred to in the text of this guide.

State Law

State law derives from state constitutions and from statutes enacted by the state legislatures. Since the concept of doing business is often expansive, you need to ascertain whether your business

activities constitute doing business in one or more states and accordingly are subject to the laws of a particular state. This law applies only in the respective state or states in which you may be doing business. State law and regulation are important in, among other areas, real estate law, corporate organization, public health and safety, environmental and labor law, and consumer protection.

Municipal Law

Municipal law usually derives from state statutes conferring specific powers on cities and towns and is usually expressed in bylaws, ordinances or regulations adopted by any of a variety of municipal bodies. It is most significant in the areas of land-use planning and public health and safety enforcement. At each of the three levels, the government imposes some form of taxation to support its operations. The principal sources of federal revenues are personal and corporate income taxes, a variety of excise taxes, and customs duties. The principal sources of state revenue are personal and corporate income taxes and a smaller variety of excises. The principal sources of municipal revenue are real estate taxes, an excise on motor vehicles and financial aid from the state government.

Lawyers in the United States

American lawyers are licensed, or “admitted to practice,” by the individual states and by the federal courts in separate federal judicial districts. In most states, there is no formal distinction between branches of the profession — as there is, for example, between barristers and solicitors in the United Kingdom. Many individual lawyers and some firms choose to specialize or concentrate their practices in particular areas of the law, but most

firms of any significant size (for example, more than 15 members) in the principal urban centers stand ready to provide legal advice and, if necessary, representation in legal proceedings in most or all the areas of concern to businesses entering the United States. Similarly, the various terms that lawyers use to describe themselves — such as “attorney,” “counsel,” “counselor” and simply “lawyer” — do not reflect any formal differences in status or specialty.

Forms of Doing Business in the United States

An important initial choice facing a person wishing to do business in the United States is the form of business entity through which to conduct U.S. operations. The choice of entity must be carefully considered in light of the specific concerns of a particular business venture. The results in terms of tax treatment, exposure to contract and tort liability, and efficiency and methods of governance will vary significantly in many circumstances depending upon the form of entity chosen. There is no single best choice of entity in the abstract; the different entities each have their own unique advantages and disadvantages. The creation, management and

“The creation, management and powers of the different forms of business entities are governed by state rather than federal law.”

powers of the different forms of business entities are governed by state rather than federal law. Additionally, the offer and sale of securities of the different entities involve both state and federal securities laws. This section briefly summarizes the characteristics of the different entities.

Corporations and joint ventures are discussed in more detail in two separate sections that follow. Remember that the appropriate choice of form varies with the plans and goals of any specific business venture. The entity is appropriately chosen only after the venture is formulated, and should be tailored to fit the venture. The venture generally should not be tailored radically to fit the entity. The use of hybrid entities, which combine the characteristics of two or more of the business forms described below, allows businesses even further flexibility in choosing entities closely matched to their individual needs.

Sole Proprietorship

A sole proprietorship is simply an individual engaging in business for himself or herself. No statute governs the organization of a sole proprietorship. However, often a person engaged in business under a name other than his/her own must file a fictitious name certificate with the office of the clerk in every town in the state in which the business has an office. The principal advantages of this form of doing business are administrative simplicity and autonomy. The owner of a sole proprietorship is his/her own boss. No one else has the right to participate in management. However, the owner may, by contract, delegate authority or surrender control. A sole proprietorship is not subject to the many record-keeping and

reporting requirements facing public corporations. The principal disadvantage of this form of doing business is potentially unlimited liability. In the absence of any contract to the contrary, a sole proprietor is personally liable for all obligations of the business to the full extent of his/her personal and business assets. In addition, a sole proprietor is liable not only for torts personally committed but also for those committed by any employees of the business. Because a sole proprietorship ends upon the death of the proprietor, this form of business organization has no continuity of existence. The interest of a sole proprietor in the business is freely transferable, subject to laws that, in general, prevent the interest of business creditors from being defeated by the sale of the business.

General Partnership

A general partnership is a collaboration of two or more individuals — by written or oral agreement — for the purpose of engaging in ongoing business activities. Partnerships are governed to a limited extent by state statutory law but, for the most part, the relationships among the partners are governed by the terms of the partnership agreement. A general partnership is not itself subject to income tax; instead, the income tax consequences of the general partnership's activities are passed through to the individual partners, who must pay taxes on their allocable share of the general partnership's income regardless of whether the partnership actually distributes any income to its partners. Additionally, a partner in a U.S. partnership is treated, for tax purposes, as if he/she were directly engaged in the business of the partnership. As a result, a non-U.S. partner may be required to file U.S. tax returns because of his/her participation in the partnership if the activities of the partnership

constitute the “conduct of a U.S. trade or business” for U.S. tax purposes. (See the “Effectively Connected Income” discussion on pages 93–94.) The primary advantage of general partnerships is that they permit great flexibility in the allocation of rights, responsibilities, and economic benefits and burdens among the participants. General partnerships allow a number of participants to pool resources while maintaining a great deal of flexibility in deciding how to run their business and how to distribute gains and losses for tax purposes. There are a number of disadvantages to the general partnership form. First, a partner in a general partnership is jointly and severally liable for all partnership obligations to the full extent of each partner’s business and personal assets. Second, the flexibility provided by the formation of a general partnership can result in difficult negotiations and complex partnership agreements. Such complex agreements, along with an elaborate taxing scheme, cause the administrative costs associated with a general partnership to be higher than those of a sole proprietorship. Additionally, the withdrawal of a partner can be cumbersome, and any such withdrawal results in the legal dissolution of the partnership. As a general rule, partnerships become increasingly unwieldy as the number of partners increases.

Joint Venture

A joint venture is essentially a form of general partnership that is limited to a single business venture. The advantages, disadvantages and tax treatment of joint ventures are the same as those of general partnerships. (Joint ventures are discussed in more detail on pages 18–21.)

Limited Partnership

A limited partnership is a partnership created pursuant to the laws of a particular state by written or oral agreement that provides for at least one general partner who is responsible for managing the partnership and at least one limited partner who is usually a passive investor. The principal advantage of a limited partnership is that it combines, to some extent, the flexibility of a general partnership with the limited liability of a corporation. A limited partnership is taxed in the same manner as a general partnership. Thus, a limited partnership is not generally subject to income tax itself; instead, the income tax consequences of a limited partnership's activities are passed through to its partners, who must pay taxes on their allocable share of the limited partnership's income whether or not the limited partnership actually distributes any income to its partners. Both general and limited partners of a limited partnership are treated, for tax purposes, as if they were directly engaged in the business of the limited partnership, and may therefore be required to file U.S. tax returns as a result of their participation in the partnership if the activities of the partnership constitute the "conduct of a U.S. trade or business" for U.S. tax purposes. (See the "Effectively Connected Income" discussion on pages 93–94.) The general partners have great flexibility in managing the enterprise within the confines of the partnership agreement and state law. Limited partners are not responsible for partnership debts and liabilities beyond the amount of their investments. Additionally, since limited partners are simply passive investors, an increase in the number of limited partners does not make the partnership unwieldy to the same extent as does an increase in the number of partners in a general partnership. A principal disadvantage of a limited partnership is that limited partners are greatly restricted in the involvement they may

A principal advantage of doing business in corporate form is that the stockholders of a corporation are insulated, in most instances, from personal liability for the obligations of the corporation.

have in the day-to-day management of the business enterprise. To protect themselves, limited partners often insist that the partnership agreement restrict the ability of a general partner to take certain key actions, such as the disposition of major assets, without the approval of the limited partners. Therefore, important decision making in limited partnerships can be slow. Further, limited partnership interests are generally securities, and therefore the offer and sale of those interests are subject to the requirements of state and federal securities laws. Unlike in a general partnership, the death, withdrawal or expulsion of a general partner does not automatically result in the statutory dissolution of a limited partnership.

Corporation

Each state has its own corporate statutes, but the laws are quite similar from state to state. (See “Forming the Corporation” on pages 13–14.) A corporation may be either public or private. A public corporation is one in which the shares are offered and sold to the public at large. A private corporation has relatively few stockholders, and the shares of a private corporation may not be transferred as freely. A principal advantage of doing business in corporate form is that the stockholders of a corporation are

insulated, in most instances, from personal liability for the obligations of the corporation. Additionally, the corporation has a perpetual existence; it does not dissolve upon the death or withdrawal of a sole stockholder. In most cases, ownership shares of a corporation can be transferred relatively easily, particularly so in the case of a public corporation.

Also, the statutory law and the case law governing corporations are well developed and hence relatively predictable. The principal disadvantage of doing business in corporate form is that the formal record-keeping and reporting requirements imposed by state corporate statutes make corporations more expensive to administer than some other forms of business entity. Administrative costs are particularly higher for public corporations, which must comply with the complex and rigorous federal securities regulation scheme under the Securities Act of 1933 and the Securities Exchange Act of 1934. Also, most corporations in the U.S. are subject to a “double taxation” system under which income of the corporation is taxed at the corporate level, and distributions of earnings to stockholders trigger a second income tax at the stockholder level. Distributions by a U.S. corporation to a non-U.S. stockholder are generally subject to U.S. withholding tax of up to 30 percent (unless reduced by treaty). Ownership of stock in a U.S. corporation does not, however, generally subject a non-U.S. person to U.S. tax return filing obligations. Private corporations are the most common form of business entity in the U.S. The public corporate form is generally the appropriate choice for businesses that require access to vast capital markets. Public and private corporations are created and governed under the same state corporate laws and are subject to identical tax treatment. The distinction between the two types of

corporations relates essentially to the application of state and federal securities laws.

Limited Liability Company (LLC)

A limited liability company (LLC) is an unincorporated entity organized under state law that combines certain advantages of both a partnership (a single level of taxation) and a corporation (limited liability to owners of the entity). LLCs avoid many of the disadvantages and requirements of so-called S-corporations, another type of entity that combines limited liability and flow-through tax treatment but prohibits foreign ownership.

The key features of an LLC are:

1. **Flow-Through Tax Treatment** — Unless an LLC elects to be taxed as a corporation for income tax purposes, it is generally taxed as a partnership. As such, an LLC is not subject to income tax itself; instead, the income tax consequences of the LLC's activities are passed through to its members, who must pay taxes on their allocable share of the income, whether or not the LLC actually distributes any income to its members. An LLC with only one member is generally disregarded for income tax purposes, and the single member must report and pay taxes on the LLC's taxable income as if that member conducted the activities of the LLC itself. Additionally, a member of a U.S. LLC is treated, for tax purposes, as if directly engaged in the business of the LLC unless the LLC is taxed as a corporation. As a result, a non-U.S. owner of an LLC may be required to file U.S. tax returns because of his/her participation in the LLC if its activities constitute the

“conduct of a U.S. trade or business” for U.S. tax purposes. (See the “Effectively Connected Income” discussion on pages 93–94.)

2. **Limited Liability** — Investors receive protection from the obligations of an LLC similar to that enjoyed by corporate stockholders.
3. **Flexible Management** — Investors may participate actively in the management of the LLC. Alternatively, management of the LLC may be delegated to a manager or group of managers who may or may not be investors.
4. **Flexible Capital Structure** — An LLC may issue multiple classes of ownership interests, may have an unlimited number of owners and is not constrained as to the types of owners who may hold interests. These features make LLCs well suited both for entrepreneurial and privately held businesses and for passive investments, including businesses that develop and sell or license technology, venture capital management, real estate investments and corporate joint ventures where the limited liability of all owners is important and where the freedom of planning distribution and allocation of LLC income and losses is desirable. One disadvantage of LLCs is that because this form of entity is relatively new, there is not a well-developed body of statutory and case law dealing with LLCs, as there is, for example, with corporations. As a result, legal developments in this area may be somewhat less predictable.

Branch of a Foreign Entity

Finally, one can do business in the U.S. as a branch of a foreign business entity. Usually, all that is required is a simple filing with the

secretary of state by a foreign entity wishing to transact business within the state. The principal advantage of transacting business as a U.S. branch of an existing foreign entity is that organizational expenses are kept to a minimum, since no new entity needs to be created. The disadvantage, however, is that doing business in such a form exposes the entity's non-U.S. assets to claims arising out of activities of the U.S. branch, as well as to possible application of a branch profits tax and the obligation to file U.S. tax returns. (See "Methods of Business Operation and Repatriation of Earnings" on pages 97–102.)

Corporations

Most U.S. businesses are organized as corporations, limited liability joint stock companies with powers to act as legal "persons" separate from their stockholders. Some businesses, particularly professional service organizations and private investment funds, may be organized as partnerships or, more recently, as registered limited liability companies or registered limited liability partnerships. This section is a brief summary of the legal formation and operation of a corporation.

Forming the Corporation

The form of entity most commonly chosen by non-U.S. businesses is the corporation, since, among other things, the corporate form provides protection for its owners against liabilities incurred in the business; a corporation can be organized quickly and relatively inexpensively; and a well-established body of statutes and case law permits the rights and responsibilities of the corporation, its owners

and management, and persons with whom it deals to be ascertained with relative clarity and certainty. A corporation is also a convenient and efficient vehicle through which to obtain outside financing (subject to compliance with applicable federal and state securities laws). Corporations in the U.S. are created under state (rather than federal) law. A corporation may be organized under the corporation law of a particular state, but not necessarily the state where the corporation will do business. Many U.S. companies choose to incorporate under Delaware law. Publicly held companies in particular may wish to take advantage of particular features of Delaware corporation law, which, for example, may permit added flexibility in matters of corporate governance such as stockholder voting or provide protection against hostile takeovers. Those provisions may provide little or no advantage, however, to a non-U.S. firm that has a wholly owned subsidiary in the U.S. You should consult with qualified counsel before selecting Delaware or another state as the jurisdiction in which to organize a corporation. An important preliminary step in organizing a corporation is, of course, to choose a name for the corporation. The name should be sufficiently distinguishable as to avoid confusion with any other corporation or entity organized or qualified to do business in the state in which the corporation will be organized and usually must

“Many U.S. companies choose to incorporate under Delaware law.”

contain a term such as “Corporation,” “Incorporated” or “Inc.” identifying the business as a corporation. It is advisable to arrange for a search to confirm that the desired name is available and, if possible, to reserve it in advance. A corporation is organized by filing a charter document, sometimes called Articles of Organization, Certificate of Incorporation, or the like (the “Charter”), accompanied by payment of a relatively modest filing fee. The information required to be included in the Charter is usually specified by the state corporate law and is not extensive. The Charter must be signed and filed. The entire process of organizing a corporation can usually be accomplished within a matter of days, if necessary. Contemporaneously with filing the Charter, the incorporators elect initial directors of, and adopt bylaws for, the new corporation. The persons elected as the initial directors then typically adopt other preliminary resolutions, for example, electing initial officers, directing the opening of a bank account, approving forms of corporate seal and stock certificate, and authorizing the issuance of capital stock of the corporation to its stockholder or stockholders. The day-to-day management of the corporation is carried out by its officers, under the general supervision of the board of directors. The board of directors appoints the officers of the corporation, generally annually. Also, the stockholders of the corporation hold an annual meeting during which directors are elected for the ensuing year. Often, it is not necessary to hold formal meetings of the stockholders or board of directors because many actions that can be taken at such a meeting can also be taken in a telephone meeting or by unanimous written consent of the stockholders or directors, as the case may be, without holding an actual meeting. The stockholders may even act by less than unanimous written consent, if the corporation’s Charter specifically

permits it and certain requirements as to prior notice to nonconsenting stockholders are fulfilled. The minimum number of required directors is determined by the corporation's charter or by state law. The officers of the corporation usually include a president, a treasurer and a secretary; any number of vice presidents and other officers are usually permitted. Officers may, but need not, be directors, and one person may serve in one or more of the statutory offices as well as act as a director. Officers need not be stockholders or U.S. residents or citizens. However, the corporation must have a registered office and a registered agent in a state. The registered agent can be an individual, including any officer of the corporation, whose business office is also the registered office of the corporation. There are companies, such as CT Corporation, that act as the registered agent for corporations. Shares of stock may be owned by any natural person, corporation or other entity, including non-U.S. citizens or entities. There is no statutory minimum investment, and, subject to certain limitations, stock can be issued for cash, promissory notes, services or other property. (Be aware, however, that inadequate capitalization of a corporation may risk loss of the limitation of liability of its stockholders.) A corporation can own or deal in real estate or any other form of property and, with limited exceptions (for example, the practice of law, medicine or another profession), can engage in almost any business activity.

Record Keeping and Filing Requirements

To maintain the limited liability of its stockholders, a corporation must observe the formalities of corporate form, such as holding regular meetings (or actions by written consent) of its stockholders and directors, maintaining corporate minutes and stock records, proper accounting for the property of the corporation, and avoiding

commingling of funds of the corporation with those of its stockholders. Corporations usually file a report of condition (or annual report) each year. Failure to file the annual report can result in imposition of fines and, if the failure continues for a period of time, in the involuntary dissolution of the corporation.

Qualification of a Corporation or Partnership to Do Business in a State

As a condition of its conducting business in most states, a foreign corporation, limited partnership or limited liability company (that is, one organized under the laws of any jurisdiction other than the one in which it is doing business) must file with the secretary of state a foreign corporation certificate, application for registration as a foreign limited partnership or application for registration as a foreign limited liability company, as the case may be. Failure to file the necessary certificate or application can result in the imposition of fines and may prevent the entity in question from bringing suit in the courts of that state. Foreign corporations may also be required to file annual certificates of condition.

Issuing Shares and Other Securities

Both federal law and state law regulate the offering or sale of securities. In this connection, the term “securities” includes many forms of investment in an enterprise and is not limited to the purchase of stock. Filings may need to be made with appropriate government agencies, and specified disclosures may need to be made to prospective investors before securities can be offered or sold to certain classes of persons. For this reason, a non-U.S. business proposing to seek outside financing for a venture in the

U.S. should consult with qualified counsel before initiating contacts with prospective investors to ensure compliance with applicable federal and state securities law.

Joint Ventures

A foreign business that wants to do business in the U.S. may desire the assistance of a U.S. business in areas such as manufacturing, marketing or product distribution, particularly if the foreign business has not previously operated in the U.S. In that situation, the foreign business may find it advantageous to enter into a joint venture with the U.S. business. A properly structured joint venture will enable a foreign business to obtain assistance in needed areas, obtain guidance and gain experience in conducting business in the U.S., and make contacts in the U.S. business community. The foreign business may then, in the future, proceed on its own, either with a new business activity or by buying out the interest of its U.S. venture partner. A joint venture arrangement may be tailored to fit any business, whether in the real estate, manufacturing, retail, service or any other sector of the U.S. economy (with limited exceptions for certain regulated industries in which foreign participation may be restricted). Joint ventures are complex arrangements requiring the consideration, analysis and resolution of legal issues in a diverse range of specialties, including tax, antitrust and intellectual property. Foreign businesses considering a joint venture arrangement should carefully select U.S. legal counsel with the experience and expertise to advise them in these areas.

Structure

As previously mentioned, a joint venture is not a specific type of legally constituted entity, as is a corporation or partnership, but is merely a generic term used to indicate the existence of a working relationship between parties that join in a common enterprise. The manner in which the parties join may vary and will be determined by a number of factors. For example, if the foreign business does not require substantial assistance, requires assistance in a narrowly defined area or requires assistance for only a short period of time, its strategy should probably be to enter into a contract with a U.S. company to provide the services required. If, however, the foreign business requires more substantial services and desires to establish a longer-term relationship with the U.S. business, the better strategy would be to form a joint venture entity to conduct the business. The foreign business will want to be insulated from liability for financial obligations and for liabilities arising from the conduct of the U.S. business, while at the same time being active in management and controlling the business. As discussed in the section on “Forms of Doing Business in the United States” on page 4, general partners of a partnership are liable for the partnership’s obligations, and limited partners of a limited partnership avoid liability only if they do not participate in the control of the business. As a result, a foreign business seeking both insulation and active management and control should not enter into a partnership directly with its U.S. joint venturer. There are two approaches most advantageous to the foreign business in organizing a joint venture. The first approach is for the foreign business to organize a U.S. subsidiary corporation. That corporation would then form a partnership with the U.S. joint venturer. The second approach is the formation of a U.S.

corporation jointly owned by the foreign business and the U.S. joint venturer. A foreign business that uses either approach and in fact maintains an arms-length relationship with the joint venture would generally achieve its goal of insulation from liabilities arising from the business of the joint venture. In addition, the foreign business would generally not be subject to the jurisdiction of U.S. courts. There are, however, exceptions. For example, a foreign business may subject itself to jurisdiction over product liability claims in the U.S. merely by sending its goods to the U.S. A foreign business whose products are sold or used as components in products that are sold through a joint venture in the U.S. should consult U.S. legal counsel to determine whether, regardless of the form of joint venture entity selected, it is prudent for the foreign business to maintain product liability insurance. Regardless of the legal form chosen to conduct the joint venture, the terms of the venture should be negotiated and documented in detail. Although legal counsel will include standard provisions developed through experience to protect the foreign business, there are many areas that will require negotiation. The joint venture documents should, for example, explicitly describe each party's present and future contributions to the venture in terms of capital, management, technology, intellectual property rights, manufacturing facilities, product distribution and the like; each party's ownership interest in, and rights to receive distributions of profits of, the venture; the duration and manner of winding up the venture; governance of the venture; a mechanism for dispute resolution, particularly in the case where each venturer has an equal ownership interest; and restrictions on transfer of the venture's interests in the joint venture. Depending on its long-term U.S. strategy, the foreign business may also find it advantageous to

negotiate, at the inception of the venture, a right to buy out its U.S. partner in the future.

Tax Considerations

Tax consequences will be a significant consideration in the type of joint venture entity selected. The entity formed to carry on the business of the joint venture will be subject to U.S. federal and state taxation. If the venture is conducted through a corporation, the venture will be subject to such taxes at both the corporate level and again when any earnings are distributed to the corporate stockholders. If the venture is conducted through a partnership, then all items of the partnership's income, losses, deductions and credits will be passed through the partnership to its partners, who will be directly responsible for payment of taxes.

In addition, the tax treaty between the U.S. and the country of the foreign business will affect the tax liability on income the foreign business receives from the joint venture. Many tax treaties require withholding of taxes in the U.S. on certain types of payments made to foreigners.

Business Financing

This section of the guide is a brief description of some of the more common types and sources of financing generally available to establish and finance the U.S. operations of a foreign business. Both U.S. and state law allow great flexibility in tailoring financing packages to the needs of particular industries and to individual businesses within those industries. Financially astute

businesspeople working with experienced legal counsel will be able to structure a financing package that is appropriate for the particular business and can be implemented within the framework of U.S. and state laws and the requirements of lenders and investors.

“A foreign business that desires to retain sole ownership of its U.S. operations will provide all the equity capital for the business.”

Equity Financing

All businesses require an adequate level of equity capital. What is adequate varies by industry and by the circumstances of a particular company within an industry. A business that anticipates substantial borrowing to finance its start-up costs and operations will need to satisfy its lenders that it is adequately capitalized. The amount of equity capital should be finally determined only after presentation to, and approval by, prospective lenders of a pro forma balance sheet for the business. As a general matter, the U.S. does not restrict the flow of funds between the U.S. and other countries. Subject to applicable reporting requirements described under the heading “Reporting Requirements for Foreign Direct Investment” on page 109, funds may be brought into the U.S. without limitation on amount and, together with any profits earned, may be repatriated without restriction on amount. Thus, a foreign business may bring into the U.S. funds needed to capitalize its U.S. operations, and funds that are no longer needed in the business or which are realized when the business is wound up may be repatriated and converted into foreign currency at the prevailing exchange rates. A foreign business that desires to retain sole ownership of its U.S. operations

will provide all the equity capital for the business. However, various sources of equity capital are available to foreign businesses.

Commercial banks in the U.S. do not provide equity capital. Investment banking firms, however, may be a source of equity capital, not only investing their own funds but also arranging for investment of equity funds by their customers. This source of equity capital will generally be available only if the foreign firm is an established business. Most of the major investment banking firms in the U.S. operate on an international basis, enabling a foreign investor to arrange equity financing in the U.S. Equity capital raised from others to establish a business in the U.S. will take the form of either common stock or preferred stock. Although state law often permits the creation of different classes of common stock, a purchaser of common stock would have the same rights per share to dividends and distributions as the foreign business holder of common stock of the U.S. company. It is more likely that a third-party equity investor will want to purchase a class of preferred stock, which will entitle the holder to a return on the investment and possibly a fixed yield on that investment before any amounts are paid to the foreign concern if the business is wound up, and that may entitle the holder to a specified level of dividends before any are paid to the holders of common stock. The preferred stock issued in such a transaction will likely be convertible into common stock at an agreed conversion rate, or may entitle the holder to participate with holders of common stock in dividends and other distributions after the preferred stockholder has been paid the preferential dividends and distributions to which it is entitled. Issuing equity securities involves negotiation of many issues, including dividend and liquidation rights and preferences, voting rights,

preferred stock conversion rights, rights to appoint representatives to the board of directors, information reporting, affirmative and negative operating covenants, remedies in the event of failure to make preferred payments when due, rights to participate in future financings of the business, rights to participate in sales of shares by other equity holders, and rights of first refusal if either the foreign concern or U.S. investor desires to sell its shares. It is likely that the U.S. investor will, in addition, want to provide an exit strategy for its investment. This might take the form of an option to require the purchase of the U.S. investor's shares after some period of time or upon the occurrence of an agreed event, a right to participate in a public offering of shares by the company or a right to require the company to register the public sale of the U.S. investor's shares. Legal counsel experienced in negotiating equity placements will be familiar with the many pitfalls in negotiating these and other issues that arise in private equity placements. Venture capital is a major source of equity capital in the U.S. for smaller and developing businesses. Venture capitalists have traditionally sought rapid-growth businesses with the potential of a public offering or sale of the business to a strategic buyer. Venture capitalists will ordinarily demand a high degree of control to protect their investment and can be expected to react relatively quickly and to insist on changes when a business does not perform as expected. They may also insist on provisions giving them control of the board of directors or actual ownership control in the event of default. Finally, given the inherent risk in venture capital investing, high returns on investments are necessary to balance the successes with the failures in the venture capitalist's portfolio. Consequently, the cost of venture capital financing may be high. With some exceptions, the public

securities markets are generally most appropriate for mature businesses, although market conditions will at times allow less-developed businesses with high growth potential to make initial public offerings at an earlier stage of development. The public securities markets are highly regulated under a system based on the concept of full disclosure of all material information. A company that offers its securities to the public is subject to extensive public reporting requirements, both at the time of the offering and on an ongoing basis. “Insiders,” including officers, directors and significant equity holders, may trade in securities of their company only on the basis of information available to the general public and are subject to various other securities trading restrictions.

Debt Financing

Debt financing is available to satisfy business needs at various stages of growth from start-up to maturity. The U.S. debt market is segmented, with different lenders providing different types of loans, and some lenders specializing in providing financing to businesses in specific industries. A foreign concern must be careful to select lenders that are knowledgeable about the foreign concern’s industry and capable of structuring a financing package that suits its particular needs. Some of the more common types and sources of debt financing are described here.

Asset-Based Loans

Asset-based loans generally provide short-term credit in the form of demand loans, seasonal lines of credit or single-purpose loans for the purchase of specific assets. Often the amount of financing available is based on a percentage of various types of assets owned

by the borrowing company. Working capital financing involves loans made against percentages of the borrower's accounts receivable and inventory accepted by the lender as collateral. The lender may also take a security interest in other assets that the lender will not include in computing the borrowing base for loans to the borrower. Commercial banks and commercial credit companies are the most common sources of this type of financing. Equipment financing may be available both to finance the purchase of new equipment and to realize cash from existing equipment. While maximum loan value and more advantageous financing terms will be available for the financing of new equipment, lenders will provide financing against a percentage of the value of existing equipment. The types of assets that may be financed in this manner extend beyond conventional equipment and machinery and include furniture, office partitions and virtually any other fixed assets. Typical sources of this type of financing are commercial banks, commercial finance companies and leasing companies. In addition, sellers of fixed assets often provide direct financing to their customers.

“Working capital financing involves loans made against percentages of the borrower’s accounts receivable and inventory accepted by the lender as collateral.”

Term Loans

For more mature companies with predictable cash flow, banks, insurance companies and pension funds provide longer-term loans. Long-term loans may have either floating or fixed rates of interest. These loans are generally unsecured, and long-term lenders rely heavily on extensive affirmative and negative covenants, including financial ratios, that set forth parameters for the conduct of the borrower's business. Long-term loans are generally used to fund working capital needs and expansion of capital assets.

Subordinated Loans

Subordinated loans, sometimes referred to as “mezzanine” loans, are term loans that are subordinated in right of payment to other loan obligations of the borrower, often obligations for loans from secured creditors and banking institutions. The term “subordination” has little intrinsic legal meaning.

The terms of subordination must be carefully negotiated in detail between the senior and subordinated lenders and must clearly set forth the relative priorities of the different lenders to the cash flow and assets of the borrower and the circumstances under which the subordinated lender is entitled to receive payments and exercise its remedies as a creditor in the event of a payment or other default on its loan. Because of the inherently greater risk that results from subordination, subordinated lenders require a considerably higher return than do senior lenders. Particularly in the case of earlier-stage companies, the near-term projected cash flow may not be sufficient to pay all the interest on both the senior and the subordinated debt. In these situations, the subordinated lender may

be willing to permit payment of a portion of its interest on a current basis and to defer payment of the balance to a time when the borrower's projections reflect adequate cash availability. The subordinated lender is likely to require that any deferred interest itself bear interest at an agreed rate. In addition, often only part of the subordinated lender's return will be reflected in the interest rate. The balance of the return is more speculative and is provided by "equity kickers," often in the form of warrants to purchase the borrower's common stock at a favorable price. In appropriate situations, a borrower's capital structure may include more than one class of subordinated debt. In that event, the terms of subordination of the more junior lenders will be negotiated separately with both the senior lender and the holders of the more senior subordinated debt. Subordinated debt financing is generally provided by insurance companies, venture capital funds that focus on later-stage growth companies and specialized mezzanine lending funds. Because this debt is subordinate to the borrower's senior debt, senior lenders will often view it as equity in performing their credit analysis.

Trade Credit

Trade credit is so oriented toward a single purpose and so short-term that it is often overlooked as a source of capital for general purposes. However, to the extent that a company is able to obtain credit from its suppliers and convert the merchandise purchased into cash to pay the suppliers within the credit term, it reduces its need to borrow from banks and commercial credit companies. The stage of development of a business has a significant effect on its ability to obtain trade credit. In the start-up phase, trade credit will be established based on financial condition, while later emphasis will shift to consistency of earnings and the payment record of the

business. A more mature business with a supplier's confidence may be able to negotiate credit terms, although suppliers are limited in this respect by the Robinson-Patman Act, which prohibits discrimination in price, terms or conditions of sale among buyers who compete with each other. (See "Antitrust and Trade Regulation" on page 103–106.)

Public Securities Markets

Debt financing in the public securities markets is available to late-stage substantial borrowers. This type of financing is generally long-term and often unsecured and may be at either a fixed or variable interest rate. While the cost of money tends to be lower and operating covenants tend to be less restrictive in publicly placed debt than in privately placed debt, the cost of issuance and ongoing transaction and reporting costs tend to be significantly higher in the public markets. In addition, the interests of holders of publicly issued debt are represented by a trustee with fiduciary responsibilities, who generally can agree to amendments or to waivers of default only with the approval of a specified percentage of the debt holders. As a result, issuers of publicly held debt will encounter less flexibility and greater delay in dealing with defaults as well as with amendments necessitated by changes in business circumstances.

Labor and Employment Relations

Productive and skilled employees are essential for the success of any business. When recruiting people to staff a business, it is important to be familiar with the basic rules of labor and employment law in the United States in three areas: hiring

employees; establishing the terms, conditions and benefits of their employment; and terminating employees. Each of these areas is discussed briefly here.

Hiring

Most employees in the U.S. do not have written employment contracts. They are hired to work on what is known as an “at-will” basis. This means that they are not employed for any definite period of time, and either the employee or the employer may terminate the employment relationship without prior notice at any time and for any reason, as long as the reason is not an unlawful one. Employers who want to employ persons on an at-will basis should have their employment application forms, offer letters, employee handbooks, and any written personnel policies and procedures reviewed by a lawyer to ensure that they do not inadvertently create enforceable contracts of employment for a particular term. Some employees, such as high-level executives, may have written employment contracts that establish a particular period of employment and describe the terms and conditions of the employment relationship. Those contracts are usually drafted with the assistance of counsel. Other employees (for example, workers paid by the hour in certain manufacturing jobs) are represented by labor unions that have negotiated collective bargaining agreements that set the terms and conditions of the employment relationship.

“A federal law, the Immigration Reform and Control Act, makes it unlawful to employ aliens in the U.S. who do not have appropriate visas authorizing them to work.”

The number of employees represented by labor unions in the U.S. has been declining in recent years, and it is unusual for labor unions to represent employees who work for high-technology and service-type businesses. Employers in the U.S. are prohibited by both federal and state laws from discriminating in the hiring of employees on the basis of race, gender (including pregnancy), age (applies to people 40 years old and older), color, religion or national origin. Federal and state laws also prohibit discrimination against qualified handicapped persons who are able to perform the essential functions of a job with or without reasonable accommodations. A federal law, the Immigration Reform and Control Act, makes it unlawful to employ aliens in the U.S. who do not have appropriate visas authorizing them to work. A separate section on “Immigration” on page 38 of this guide describes the types of visas available under U.S. law. Larger employers (those with 50 or more employees) that do business with the federal government and have a contract in excess of \$50,000 may have to prepare written affirmative action plans in an effort to recruit and promote qualified women and minorities in their workforces.

Terms and Conditions of Employment

For the most part, employers in the U.S. are free to determine the compensation and benefits for their employees without any regulation by the government. There are, however, some important exceptions to this general rule, as described more fully below.

Wages

A federal law, the Fair Labor Standards Act, requires most employers to pay their employees a minimum wage. Some states have minimum wages higher than that required by federal law.

Additionally, employers are usually required to pay overtime premiums at the rate of one and one-half times an employee's regular rate of pay for all hours worked in excess of 40 in a week. Except in the case of minor children, there is no limit on the number of hours that employees can be required to work in a week as long as they receive one full day of rest in each seven-day period. Certain salaried employees who are employed as executives, professionals or administrative personnel are exempt from these minimum wage and overtime pay requirements.

Workers' Compensation for Injured Employees

In every state, employers must provide workers' compensation benefits to employees who are injured during the course of their employment. These benefits are typically provided through private insurance that the employer obtains at or before the time employees are first hired. The cost of the insurance is determined by factors such as the size of the employer's payroll, the nature of the business (for example, construction, manufacturing or office work) and the employer's prior record concerning benefits paid to injured employees. The benefits that injured employees receive are set by law. The benefits are the employee's sole remedy for work-related injuries or illnesses, and employees may not bring court claims against their employers for additional benefits.

Unemployment Compensation for Terminated Employees

Employers must also pay a quarterly tax on part of their total payroll to fund unemployment compensation benefits for employees who are terminated involuntarily. The tax rate for each employer is determined

in part by how much money the state needs to fund this program and in part by the claims experience of each individual employer.

Vacations and Holidays

It is common for employers to provide employees with paid vacation time. The amount of paid vacation a particular employee receives is typically determined by his/her length of service or position. It is not unusual for employees to receive from one to four weeks of paid vacation time in a year.

Health Insurance

Under federal law, employers are not required to provide health insurance benefits for their employees, but the majority of employers do voluntarily provide some type of group health insurance coverage in order to attract and retain capable employees. The cost of such insurance can vary substantially. Typically, an employer pays either a percentage of or all the cost of the insurance. Once an employer adopts a plan that provides health benefits for employees and/or their dependents, there are federal and state laws that establish certain requirements for these plans. For example, there is a federal law that applies to employers with 20 or more employees, called the Consolidated Omnibus Budget Reconciliation Act (COBRA), which allows terminated employees and certain other participants in group health plans to continue their coverage at their own expense after they leave their employment. Although not required by law, it is customary for employers to allow employees occasional days of absence due to sickness or injury without loss of pay. Many employers have detailed sick-leave

policies specifying the number of days allowed per year or other period, and similar matters.

Leaves of Absence

A federal law, the Family and Medical Leave Act of 1993 (FMLA), requires employers with 50 or more employees to allow up to 12 weeks of unpaid leave in a 12-month period for one or more of the following reasons: (a) the birth and care of a newborn child of an employee; (b) the placement with an employee of a son or daughter for adoption or foster care; (c) to care for an immediate family member (spouse, child or parent) with a serious health condition; or (d) to take medical leave when an employee is unable to work because of a serious health condition. During FMLA leave, an employer must maintain an employee's group health insurance coverage with the same terms as before the leave began. Upon return from FMLA leave, an employee must be restored to his/her original job or an equivalent job. Similar employee benefits are often mandated by state law.

Retirement Benefits

Under the Social Security program administered by the federal government, all employers must withhold a percentage of each employee's wages each pay period and forward those amounts, together with an additional wage-based tax paid by employers, quarterly to the federal government to fund retirement and other benefits. It is also fairly common for employers to voluntarily provide some type of program to enable employees to accrue retirement benefits. Retirement and other benefit programs are regulated by a federal law known as the Employee Retirement Income Security Act (ERISA). It has recently become more common for employers to

establish plans that enable themselves and/or their employees to make tax-deferred contributions to individualized retirement benefit plans. This is a complex area of the law that requires special legal assistance.

Life and Other Insurance

Employers sometimes voluntarily provide group term life insurance, accidental death and dismemberment insurance, and/or long-term disability insurance for their employees at either the employer's or the employee's cost.

Safety and Health

There is a federal law called the Occupational Safety and Health Act (OSHA) that establishes minimum safety standards that employers must follow. Depending on the nature of the business, compliance with these regulations may require significant effort.

Labor Unions

Another federal law, the National Labor Relations Act (NLRA), protects employees from discrimination or termination for engaging in collective activities or organizing to form labor unions for the purpose of bargaining with their employer about wages, hours of work, or other terms and conditions of employment. When a union represents employees, many of the wage and benefit policies that are described above as voluntary may become subject to collective bargaining with the union and may become mandatory under an agreement negotiated with the union. This is a complex law, and special legal assistance is required if, for example, you are acquiring a business that has union-represented employees.

Protecting an Employer's Assets

Employers sometimes require employees to sign certain written agreements as a condition of obtaining employment in order to protect the employer's confidential information, to secure the employer's right to certain intellectual property, or to prohibit employees from leaving their employment and going into competition with them. Such agreements are particularly important and common for employers that are engaged in high technology businesses. Employment agreements concerning patents, inventions, copyrights, noncompetition, confidential information, conflict of interest rules and similar matters are usually drafted with the assistance of a lawyer.

Terminating Employees

In most states, "at-will" employees (that is, employees who do not have employment contracts for a particular term or who are not covered by union-negotiated collective bargaining agreements) may be terminated at any time and for any reason, as long as the reason is not an unlawful one. Generally, there are no particular procedural requirements that must be followed in terminating an at-will employee. Examples of unlawful reasons for termination include discharging an employee because of his/her race, gender (including pregnancy status), age (applies to people 40 years old and older), color, religion, national origin, or disability or handicap (if the person is qualified to perform the essential functions of the job with or without reasonable accommodations).

“Generally, there are no particular procedural requirements that must be followed in terminating an at-will employee.”

Employers usually are not required to inform terminated employees, either verbally or in writing, of the reason for their termination, although it is customary to do so. It is important that an employer give the complete and accurate reason for an employee's termination if it chooses to give a reason. Employees who are covered by union-negotiated collective bargaining agreements ordinarily can be terminated only for "just cause" or the like. Some employers voluntarily provide severance pay to terminated employees, particularly if the termination resulted from a "layoff," a workforce reduction due to the elimination of redundant positions or for other economic reasons. Plans that provide employees with severance pay should be reproduced in writing and conform to certain other requirements in ERISA. There is a federal law called the Worker Adjustment and Retraining Notification Act (WARN) that requires employers with 100 or more full-time employees to provide 60 days' written notice to employees or their union representatives and other officials in the event of a plant closing or mass layoff at a single site of employment. There may be similar state law requirements in some states. As noted above, involuntarily terminated employees may be eligible for unemployment compensation benefits, which would be paid directly by the state government. Additionally, under COBRA, terminated employees and their dependents are entitled to continue their group health insurance coverage at their own expense for various periods as long as 36 months after particular events occur.

Immigration

The system for regulation of foreign nationals coming to the U.S. is administered by the U.S. Citizenship and Immigration Services (USCIS), the U.S. State Department and the U.S. Department of Labor. To enter and remain in the U.S., a foreign national must qualify for and, in most instances, obtain a visa. Broadly speaking, these visas fall into two categories: temporary nonimmigrant visas and permanent resident visas.

Temporary Nonimmigrant Visas

Nonimmigrant visas are issued to foreign nationals who are coming to the U.S. for a temporary purpose and will maintain a permanent residence abroad. A nonimmigrant visa permits a foreign national to enter the U.S. for a specific purpose and for a limited period of time. Most classes of nonimmigrant visa do not permit the foreign national to work in the U.S., and many require advance approval from the USCIS. The most common visa categories utilized by foreign nationals are:

B-1: Visitor for business purposes coming to the U.S. on a short trip for a foreign employer. Typically, an individual's initial admission in this status is limited to a maximum of six months. This visa status does not normally authorize an individual to work for a U.S. employer. The U.S. has implemented a visa waiver program that enables foreign nationals of many countries to enter the U.S. under B-1 status without obtaining a visa in advance.

B-2: Temporary visitor for pleasure (tourist). The visa waiver program available to nationals of certain countries also applies to the B-2 visa category.

H-1B: Foreign national in a “specialty occupation” that normally requires attainment of at least a bachelor-level degree, coming to the U.S. to perform services requiring such skills. In addition, the employer must make certain attestations concerning wage levels and conditions of employment. USCIS must approve a petition in advance, and the maximum length of stay in H-1B status is typically six years. There is also an annual “cap” on the number of H-1B petitions that can be approved each year and, for the past several years, USCIS has reached that cap.

H-2: Other skilled workers who are coming temporarily to the U.S. and who will not displace a U.S. worker. Entry in H-2 status requires prior approval of a labor certification application by the Department of Labor, as well as prior approval by USCIS. The maximum length of stay is typically one year.

H-3: Foreign national coming to the U.S. to complete a formal training program, which can include programs maintained by U.S. employers. The principal activity in the training program cannot be productive employment. Prior approval by USCIS is required, and the length of stay is defined by the duration of the program.

L-1: Intracompany transferee who is an executive, manager or individual possessing specialized knowledge of an international company’s products or operations. The individual must have worked abroad for the company or an affiliate for at least one year in the immediately preceding three years. Prior approval by USCIS is required, and the maximum period of stay is five to seven years.

TN-1: This visa status is available only to Canadian and Mexican nationals pursuant to the North American Free Trade Agreement (NAFTA). It permits qualified Canadian and Mexican professionals to

enter the U.S. without first obtaining prior USCIS approval or a visa. “Professionals” generally include individuals within certain job categories listed in NAFTA.

O: Foreign national of “extraordinary ability” in the sciences, arts, business or education, as demonstrated by sustained national or international acclaim. This requires advance approval by USCIS. An individual can be admitted in this status for whatever period of time is required to complete the purpose of his/her trip.

P: Performing artists and athletes who perform at an “internationally recognized” level. Advance USCIS approval is required, and the foreign national is admitted for the period required for his/her performance.

E-1: Foreign national coming to the U.S. pursuant to a treaty of trade or commerce to foster international trade between the U.S. and his/her native country. To qualify, there must be a treaty of trade between the U.S. and the foreign employer’s country, the individual must have the same nationality as the employer, and there must be substantial trade by the company between the U.S. and that country. The U.S. consulate in the foreign country can approve these visas, and there is no fixed limit on how long the individual can remain in the U.S.

E-2: Foreign national coming to the U.S. pursuant to a treaty of trade between the U.S. and his/her native country in connection with a substantial U.S. investment. Again, there must be an appropriate treaty of trade, the visa can be issued by the U.S. consulate without prior USCIS approval, and there is no fixed limit on the length of stay.

E-3: A special visa category available to Australian nationals under a U.S.-Australia treaty. The substantive requirements for this category are similar to the H-1B category described, but the process of obtaining the visa does not require advance USCIS petition approval, and there is a separate annual cap for this category.

F-1: Students coming to the U.S. to pursue a course of study leading to a degree. The individual is admitted for the duration of his/her studies and, in certain circumstances, can receive authorization to work.

J-1: Exchange visitor coming to the U.S. for purposes of an international exchange of knowledge. These programs require prior approval from the U.S. Information Agency and, in some instances, participants in such a program must return to their native country for two years after completion of the program. J-1 exchange visitors may be eligible to work in certain circumstances.

Permanent Residence

A permanent resident visa allows a foreign national to live and work indefinitely in the U.S. A foreign national can seek permanent resident status on the basis of a qualifying job offer from a U.S. employer, a qualifying investment in the U.S., or a qualifying relationship with a U.S. citizen or permanent resident. Because there is a limited number of permanent resident visas available each year in many categories, there can often be a substantial waiting period to obtain permanent residence. To qualify for permanent resident status on the basis of a job offer, a foreign national must fit into one of the following categories:

- Priority Workers: Individuals with extraordinary ability in the arts, sciences, education or business; outstanding professors and researchers; and certain executives and managers of multinational companies
- Professionals: Individuals holding an advanced degree (not a bachelor's degree) and individuals of exceptional ability
- Skilled Workers: Individuals with a bachelor's degree or who will perform duties that normally require at least two years of specific training or experience
- Other Workers: Low-skilled or unskilled labor

For individuals in the latter three categories, the employer must normally first obtain a labor certification from the U.S. Department of Labor; USCIS can waive the labor certification process for professionals whose employment is deemed to be in the “national interest”. To do so, the employer must demonstrate, through the completion of prescribed recruitment activities, that there are no qualified U.S. workers available to undertake the work. The Department of Labor has recently implemented an automated

“Since 1986, federal law has made it unlawful for an employer to employ a foreign national who is not authorized to work.”

“PERM” labor certification program, which has significantly expedited the processing of labor certification applications.

- **Investors:** To qualify for permanent residence on the basis of an investment in the U.S., a foreign national must invest at least \$1 million (this requirement is reduced to \$500,000 if the investment is made in certain economically disadvantaged areas) in a new venture that can be expected to employ at least 10 U.S. workers within two years. Alternatively, the investment could also be made in an existing business that is in economic trouble. To obtain permanent residence through a qualifying investment, the foreign national must file a petition with USCIS documenting the amount and nature of the investment.

Employer Sanctions

Since 1986, federal law has made it unlawful for an employer to employ a foreign national who is not authorized to work. Federal law also imposes on employers an affirmative duty to verify and record on an I-9 form the identity and status of every new employee. At the same time, the law prohibits employers from discriminating on the basis of national origin, citizenship status or impending citizenship status. Violation of any of these provisions can result in substantial civil penalties and, in extreme cases, criminal penalties.

Protection of Intellectual Property

Many companies count intellectual property among their most valuable assets. The acquisition or right to use intellectual property is the force driving many business transactions today. Increasingly,

lenders and financiers look to a company's intellectual property assets to support its financing needs. Under federal and state law, these intellectual property assets may be protected as patents, copyrights, trademarks or trade secrets. Some assets can also be protected by principles of unfair competition. Some types of intellectual property may be eligible for more than one form of protection. For example, computer programs are often subject to patent, copyright and trade secret protection, and their names may be protected as trademarks.

Patent Law

Patents are exclusively matters of federal law, governed by the 1952 Patent Act, as amended. The Patent Act provides for three types of patents:

- **Utility Patents:** Protect the utilitarian aspects of a process, machine, manufacture or composition of matter
- **Design Patents:** Protect the ornamental external design of an article of manufacture
- **Plant Patents:** Protect only distinct and new varieties of asexually reproduced or cultivated nontuberous plants

Eligibility for Patent

The Patent and Trademark Office of the Department of Commerce (PTO) issues patents after evaluation of applications submitted by inventors. To be eligible for a patent, an inventor must demonstrate that the invention, design or plant is novel and nonobvious.

- **Novelty.** The novelty requirement will be satisfied if (a) the applicant was the first to invent the invention, (b) the invention was not known or used in the U.S. or patented or published in any country before the date of creation by the applicant, and (c) the invention was not in public use or on sale in the U.S. more than one year prior to filing the application for patent.
- **Nonobviousness.** An invention is “nonobvious” when the differences between the invention and the previously known body of knowledge are such that the invention would not have been obvious to a person having ordinary skill in the art.

Patent Owner's Rights

Once a patent is issued, the patent holder is protected during the term of the patent against (a) the unauthorized use, sale, offer for sale or manufacture of the invention within the U.S.; (b) the unauthorized importation of the invention into the U.S.; or (c) the importation of a product that is made abroad under a process patented in the U.S. The duration of patent protection differs for the different types of patents:

- Utility and plant patents filed after June 8, 1995: 20 years from the filing date
- Utility and plant patents filed or issued before June 8, 1995: The longer of 20 years from the filing date or 17 years from the issue date
- Design patents: 14 years from the issue date

Unlike some foreign jurisdictions, there is no working requirement or compulsory licensing for U.S. patents in most cases. However, patent holders may apply a prohibition on “abuse of patent” to prevent certain restrictive or anticompetitive practices.

International Conventions Concerning Patents

The U.S. is a party to the Paris Convention, the Union for the Protection of New Varieties of Plants (UPOV) and the Patent Cooperation Treaty. The Paris Convention and the UPOV, as they apply to botanical plant varieties, accord the citizens of each member state national treatment and a right of foreign priority. National treatment gives citizens of member states access to foreign patent protection to the same extent as nationals of the foreign state. Foreign priority entitles inventors in member states to the benefit of an earlier filing date if a counterpart patent application was filed abroad, provided that a later application is filed within the priority period, which under the Paris Convention is one year. The Patent Cooperation Treaty establishes a mechanism for initially filing a single, uniform, international patent application and extends the priority period of the Paris Convention.

Copyright Law

Most copyrights are also exclusively matters of federal law, governed by the 1976 Copyright Act and its amendments. Copyrights are exclusive rights in works of artistic or intellectual expression.

Eligibility for Copyright

Copyright protection is available for original works of authorship fixed in a tangible medium of expression. These include:

- Literary works (those expressed in words, numbers, or other verbal or numerical symbols such as books, lyrics, catalogs, compilations and directories)
- Musical works
- Dramatic works
- Pantomimes and choreographic works
- Pictorial, graphic and sculptural works (two- and three-dimensional works of fine, graphic and applied art; photographs; prints; maps; globes; charts; technical drawings; diagrams and models)
- Motion pictures and other audiovisual works
- Sound recordings (works that result from the fixation of a series of musical, spoken or other sounds, but not sounds accompanying an audiovisual work)
- Architectural works

Copyright protection as literary works is available for computer programs, to the extent that the program incorporates the programmer's expression of original ideas as distinguished from the ideas themselves. Unlike other literary works, computer software generally cannot be rented without authorization of the copyright holder.

Copyright Owner's Rights

Copyright protects the owner from unauthorized copying, distribution, performance and display of the work, and from unauthorized creation of translations and other derivative works. Copyright in the U.S. also protects the “moral” rights of attribution and integrity, but only with respect to works of visual art. Copyright law distinguishes between an idea and an expression of an idea. Only the expression is protected. Thus, copyrights do not protect the owner from use by others of any idea, procedure, process, system, method of operation, concept, principle or discovery revealed by the copyrighted work.

Vesting of Rights

Copyrights in a work automatically vest in the author or joint authors when the work is first set down in tangible form. No registration or filing is necessary. Copyrights remain vested in the author or authors for the duration of the copyright unless they are transferred by written assignment.

An employer will be the author of a work, and therefore hold the copyrights in the work, in the special case of a “work made for hire.” A work made for hire is:

- Work prepared by an employee within the scope of his/her employment; or
- Work prepared by a nonemployee, if it is specially commissioned for use as a contribution to a collective work, part of a motion picture or other audiovisual work, a translation, a supplementary work, a compilation, an instructional text, a test, answer material

for a test, or an atlas, and the parties expressly agree in a written instrument signed by them that the work shall be considered a work made for hire. A work made for hire created by an employee may fall into any of the categories of works covered by the Copyright Act. However, works created by nonemployees can become works made for hire only if (a) they fall into one of the special categories listed above and (b) the parties expressly agree in a signed document that it is to be considered a work made for hire. If it does not fall within one of the special categories, the parties may nevertheless agree to assign copyright to the party commissioning the work. In that case, the “author” will be deemed to be the person who actually created the work; the commissioning party will become the owner of copyright by reason of the assignment. Since many consultants, advertising agencies, independent contractors and other nonemployees create works that do not fall within the listed categories, ownership of copyrights in such works must be obtained by an express written assignment.

Duration of Copyrights

The duration of copyright protection depends upon who the author is, when the work was created and when federal copyright protection was first obtained. For works created on or after January 1, 1978, the following terms apply (the term may not be extended):

- A work of an individual author is protected for the life of the author plus 70 years.
- Joint works prepared by two or more authors are protected for the life of the last surviving author plus 70 years.

- Anonymous works, pseudonymous works and works made for hire are protected for 95 years from the date of publication or 120 years after creation, whichever is shorter. In addition, restoration of copyright is available for certain works of foreign origin that have fallen into the public domain in the U.S. but are still subject to valid copyright in their source countries. Restoration is generally available for works that fell into the public domain due to (a) noncompliance with U.S. formalities, (b) lack of subject matter protection, in the case of sound recordings fixed prior to February 15, 1972, or (c) lack of national eligibility for protection. The owner of a restored copyright must file a Notice of Intent to Enforce copyright in order to restrain parties acting in reliance upon the lapse of rights. Such parties must stop using the work within 12 months after being notified of the restoration of rights.

Formalities

Since 1989, federal law has not required the formalities of notice or registration to establish copyrights. However, it is still advisable to apply a copyright notice to each copy of a work and to register copyrights in a work. The copyright notice consists of three elements: the word “copyright,” “copr.” or the copyright symbol “©”; the year of first publication; and the copyright owner’s name. Notice can prevent inadvertent infringement and prevent an infringer from mitigating damages by claiming innocent infringement. Registration is still a prerequisite for many copyright infringement actions for works first published in the U.S., for perfecting security interests in copyrights, for recording transfers of copyright so as to give constructive notice of the transfer and for recording the copyright with the Copyright Office. (Registration is not a

prerequisite for a U.S. copyright infringement action for certain works of foreign authors first published outside the United States.) Registration provides prima facie evidence of the owner's title to the work and entitles the owner to claim statutory damages and attorney's fees in some infringement actions and other benefits.

Moral Rights

Protection for moral rights (or *droit moral*) is much more limited in the U.S. than in some other countries. The 1990 Visual Artists Rights Amendment to the Copyright Act grants to the author of a work of visual art the rights of attribution and integrity for the life of the author, without granting such rights to any other type of copyrightable work.

Right of Attribution

This right allows an author to claim authorship of a work and to prevent the use of his/her name in a work of visual art that the author did not create.

Right of Integrity

This right allows an author to prevent the use of his or her name as the author of the work of visual art in the event of a distortion, mutilation or other modification of the work that would be prejudicial to the author's honor or reputation.

International Copyright Conventions

The U.S. is a party to the Universal Copyright Convention (UCC), the Berne Convention, the Agreement on Trade-Related Aspects of

Intellectual Property Rights (TRIPS) and the agreement establishing the World Trade Organization (WTO).

- **Universal Copyright Convention:** Under the UCC, signed by the U.S. as a compromise between the Berne Convention and the then-current U.S. copyright law, works by nationals of member nations and works first published in member nations are entitled to national treatment in every other member nation, if the work is unpublished or carries the prescribed notice. Member states, however, can impose additional requirements on their own nationals.
- **Berne Convention:** The Berne Convention specifies minimum levels of copyright protection and requires the principle of national treatment without requiring any formalities.
- **Agreement Establishing the World Trade Organization (WTO):** This agreement establishes a formal institutional framework for resolving trade disputes among member states. It was concluded as part of the Uruguay Round negotiations under the General Agreement on Tariffs and Trade (GATT) in 1994.
- **Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs):** TRIPs establishes standards for the availability, scope, use and enforcement (through the WTO, if necessary) of intellectual property rights, including patent, copyright and trademark rights. It also was concluded as part of the Uruguay Round negotiations in 1994.

Copyright Infringement Liability and the Internet

Signed into law on October 28, 1998, the Digital Millennium Copyright Act (DMCA) established procedures by which online service providers (OSPs) can limit their liability for damages arising from the copyright-infringing activities of their subscribers.

Definition of an OSP: To be eligible for the limitations of liability under the DMCA, a party must be an OSP. The DMCA has two definitions of OSP:

- For purposes of an OSP engaged in transitory digital network communications, it is defined as “an entity offering the transmission, routing, or providing of connections for digital online communications, between or among points specified by a user, of material of the user’s choosing, without modification to the content of the material as sent or received.” This is a very broad definition, and includes almost any online service provider.
- For all other purposes, an OSP is defined even more broadly as “a provider of online services or network access, or the operator of facilities therefore,” including an entity under the previously mentioned definition. This definition includes almost any Web site owner.

Safe Harbors for OSPs

Under the DMCA, an OSP may qualify for a safe harbor to shield against liability for copyright infringement for third-party content. To qualify for a safe harbor, the conduct of the OSP must fall into at least one of four separate categories of conduct enumerated in the DMCA. Each category has a separate set of requirements to qualify

for the safe harbor protection. Included in the requirements is a “notice and take down” procedure, in which an OSP must adopt and reasonably implement a policy of removing or disabling access to alleged infringing material upon proper notice of infringement. Also, the OSP must accommodate and not interfere with accepted industry standards for identifying or protecting copyrighted works.

Anti-Circumvention

The anti-circumvention rules of the DMCA prohibit the circumvention of technical measures that prevent access to copyrighted work. The rules also prohibit manufacturing, importing, offering to the public, providing or trafficking in any technology, product, service, device or component for the purpose of circumventing measures that protect copyright owners. The DMCA makes the violation of these anti-circumvention rules a criminal offense.

Mask Works

Mask works, such as the two-dimensional and three-dimensional features of the shape, pattern and configuration of the layers of a semiconductor chip product, are accorded sui generis protection under Chapter 9 of the Copyright Act. Mask works are not afforded the same protection as copyrighted works; timely registration is required, and the duration of protection is limited to two years from the earlier of registration or first commercial exploitation anywhere in the world. A mask work may not be reproduced, imported or distributed without the authority of the owner.

Trademark Law

Trademark protection is provided by both federal and state law and is founded on the common-law notion that a business has a right to the exclusive use of those marks that distinguish its goods or services from those of others. Unlike trademark rights in most countries, this right is based on the business' use of the mark; there is no registration requirement. A business that uses a mark in commerce, even without registering the mark, can prevent others from subsequently adopting and using confusingly similar marks for related goods or services. However, one may apply for federal registration of a mark before it has been used, based upon a bona fide intention to use it. In that case, rights to the mark will be retroactive to the date of application if it is approved by the Patent and Trademark Office, is not successfully opposed by any other person, is actually used within the statutory time period, and is then registered.

Types of Marks

A mark is typically a name or word capable of identifying and distinguishing goods or services of one source from those of other sources. A mark can also be a:

- phrase,
- fragrance,
- symbol or logo,
- telephone number,
- graphic design,

- series of sounds,
- set of numbers,
- series of letters,
- distinctive design of a product container, or
- distinctive combination of colors.

This list is by no means exhaustive. However, functional features of a product are not entitled to trademark protection, nor are the generic names of goods or services.

Federal Registration

A trademark that is in use in interstate or foreign commerce may be registered under the federal trademark law, known as the Lanham Act. Upon application for registration, the PTO will conduct an examination to determine whether the mark is eligible for registration. A mark will be refused registration on the federal Principal Register for the following reasons, among others:

- It is confusingly similar to a previously used or registered mark not yet abandoned,
- It lacks distinctiveness because it is merely descriptive or geographically descriptive, or is primarily a surname, and the mark has not acquired distinctiveness through use,
- It is a common descriptive or generic name for goods or services,
- It is scandalous or disparaging,

- It is an insignia of a governmental entity, or
- Without consent, it identifies a living individual or a deceased president during his widow's life.

Registration on the federal Principal Register provides the registrant with the following rights, among others:

- The prima facie right to exclusive ownership of the mark,
- The prima facie right to exclusive use of the mark in commerce in connection with the specified goods and services during the initial ten-year term and any renewal terms, and
- The right to use the registration symbol.

Merely descriptive marks and mere surnames may be eligible for registration on the federal Supplemental Register. The “®” registration symbol may be used with marks registered on the Supplemental Register as well as marks registered on the Principal Register. Use of the registration symbol “®” acts as constructive notice to an infringer and may allow the registrant to recover profits and damages from an infringer without giving actual notice of registration. A registration requires periodic maintenance, and may be renewed in successive periods of ten years.

State Registration

Registration is often more easily obtained at the state level because the mark need not be in use in interstate commerce and the examination of the application by the state trademark office is not

particularly rigorous. The restrictions on registration of a mark are similar to the federal restrictions listed above.

Trade Secret Law

A trade secret may consist of any formula, pattern, device or compilation of information or other know-how that is used in a business and gives that business an opportunity to obtain an advantage over competitors that do not know or use it. Trade secrets commonly include formulae for chemical compounds, processes of manufacture, patterns for machines or other devices, confidential business information such as new product lines or marketing initiatives, and customer lists. Indeed, in the U.S. anything may be a trade secret, as long as it is maintained in secrecy and provides a competitive advantage. Six factors are commonly used in determining whether particular information is a trade secret: (1) the extent of disclosure of the information inside the business, (2) the extent of disclosure outside the business, (3) the measures taken to prevent disclosure of the secret, (4) the value of the information, (5) the effort or funds expended to develop the information, and (6) the difficulty or ease with which the information could be legally acquired or duplicated by others.

The distinguishing characteristic of trade secrets is their secrecy. Therefore, protection requires that those who know the secret agree or are otherwise obligated not to disclose it. The number of authorized people aware of the secret does not affect protection of the trade secret, as long as none of them discloses it to anyone else. Trade secrets are generally protected through written nondisclosure agreements with employees, written license and nondisclosure

agreements with authorized users, and establishing and carrying out secrecy policies and practices. If a trade secret is disclosed or used by an unauthorized party, its owner or licensee can bring either a civil or criminal action for trade secret misappropriation. Relief for trade secret misappropriation is more variable and in some cases broader in the U.S. than in many other countries.

Unfair Competition Law

Both federal and state law prohibit the misappropriation and misuse of intellectual property under a theory of unfair competition.

Section 43(a) of the Lanham Act, the federal law protecting trademarks, specifically prohibits the use of false designations of origin and false descriptions or representations of goods or services in commerce. Both the person who creates the false designation or description and the person having knowledge of the false designation or description who causes or procures the goods or services to be transported or used in commerce may be civilly liable for violation of this section. Any person doing business in the falsely designated area or any person who believes that he/she is likely to be damaged by use of the false description may bring a civil action against the false designator.

Transfer of Proprietary Rights

Copyrights

The transfer of copyrights in a work, or any copyright, requires a written document referencing the copyrights and signed by the owner of the copyrights conveyed. To be effective against

subsequent conflicting transfers, the copyrights must be registered with the U.S. Copyright Office, and the transfer must be recorded in the Copyright Office Register within the specified time period.

Patents

A signed written document is also required to transfer a patent, any interest in a patent or a patent application. To be effective against subsequent purchasers or mortgagees, the instrument must be recorded in the Patent Assignment Division of the PTO within the specified time period.

Trademarks

A trademark may be assigned only with the goodwill associated with the mark. A pending application for federal registration based on intent to use may be assigned only if the applicant has an ongoing and existing business and the assignee succeeds to the business of the applicant. Assignment of federal registration of a mark or an application for registration requires a signed written instrument. To be effective against subsequent purchasers or mortgagees, the document must be recorded in the Trademark Assignment Division of the PTO within the specified time period.

Trade Secrets

Trade secrets are not a title-based form of property and therefore are often difficult to identify as assets. A person seeking to obtain rights in a trade secret will want to describe the asset in the transfer documentation. The transfer documentation usually

includes the agreement of the transferor not to disclose the trade secret to anyone else and an assignment of the transferor's rights to enforce the confidentiality obligations of employees, customers and others who may have had access to the secret. There is no system for registering such rights or recording such documents.

Partial Transfers and Licenses

Written instruments are desirable, but not necessarily required, to establish an enforceable license of intellectual property rights. Licenses are not generally transferable without the consent of the licensor.

Privacy and Information Security

The protection of personal, financial and medical information is a rapidly developing area of the law. There is no single, comprehensive law that protects an individual's privacy or regulates disclosure of personal information in the United States. Rather, such protection has evolved under a variety of federal and state laws and regulations, often relating to particular industries or categories of data. Key areas of law include the following:

Identity Theft and Personal Information

The majority of states have enacted identity theft prevention statutes and regulations that require individuals and businesses that handle personal information to adopt and implement information security programs. In general, "personal information" under these laws includes an individual's name in combination with a Social Security number, state driver's license or identification number, or

a financial account number, such as a credit card or bank account number. Many states require notification when personal information has been involved in a security breach. The specific requirements of these laws and regulations vary between states.

Regulation of Financial Information

The *Graham-Leach-Bliley Act* (GLBA) regulates the use and disclosure of nonpublic personal information by financial institutions. Disclosure of such information is prohibited unless the customer has received notice of the institution's policies and practices regarding disclosure and has been given the opportunity to opt out. Federal agencies, including the Federal Trade Commission (FTC) and other federal regulatory agencies, have issued regulations under the GLBA that require financial institutions to implement information security programs to protect this financial data. The *Fair and Accurate Credit Transactions Act* (FACT Act or FACTA) sets limits on the use and disclosure of data derived from credit reports. Among other things, FACT Act regulations require that financial institutions take steps to protect this data from unauthorized use. Federal agencies such as the FTC have issued *Red Flag Rules* pursuant to the FACT Act, requiring that financial institutions and creditors develop written identity theft prevention programs. These programs must identify "red flags," the shorthand term for warning signs of identity theft, and take steps to deter the unauthorized use of personal financial data.

Regulation of Health Information

Although its name does not suggest it, the *Health Insurance Portability and Accountability Act* (HIPAA) is the federal statute that governs the use of an individual's health information and

electronic personal health information. Health care providers are HIPAA “covered entities,” and third parties who come in contact with covered entities and their health information are “business associates.” HIPAA, as amended in 2009 by the HITECH Act, requires that both covered entities and business associates adopt written policies to protect personal health information. HIPAA also requires that covered entities and business associates make formal notification when there has been a security breach. A number of states have passed similar laws to impose even greater obligations on certain entities to protect personal health information.

Collecting Information Online

The *Children’s Online Privacy Protection Act* (COPPA) prohibits collection of personal information from children younger than age 13 without parental consent. It requires operators of websites directed to children younger than age 13 that collect personal information from those children to provide proper notice of the collection of the information, appropriate consent to collect the information, and access to it by parents upon request. COPPA also requires the information collected to be limited to only that which is reasonably necessary to track online activity and to be protected by reasonable procedures. The FTC has specific guidance for businesses on how to comply with COPPA. If a website operator is in compliance with an FTC-approved guideline of a self-regulatory industry organization, it may qualify for the safe-harbor provision of COPPA.

A number of federal and state statutes require that any access to an individual’s computer, email and electronic communications be

authorized. The *Electronic Communications Privacy Act* (ECPA) and the *Stored Communications Act* (SCA) protect the privacy of e-mail or other electronic communications both while in transit and when stored on a computer or other device. Specifically, the acts protect against unauthorized access, interception or disclosure of private electronic communications, including email, by government or individuals. Similarly, federal and state wiretap acts expressly prohibit the recording or interception of electronic communications unless sufficient consent is obtained. The *Computer Fraud and Abuse Act* (CFAA) prohibits unauthorized access to Internet-connected computers.

Internet Privacy Policies

The misuse of personal information on the Internet is a significant concern for many consumers, and this has led companies doing business on the Internet to post privacy notices or policies online. Whether this is voluntary or required under federal or state privacy laws, it is critical that any privacy policy adopted be carefully followed. A business that deviates from its privacy policy may be liable for “unfair or deceptive acts or practices” under both federal and state law. The FTC routinely fines companies under the FTC Act when companies have failed to meet their own stated privacy policies. These businesses may also be subject to enforcement by state agencies as well as to civil lawsuits for compensatory and punitive damages under state consumer protection statutes.

Restrictions on Electronic and Other Communications

A number of federal and state laws regulate the sending of electronic communications by businesses. The federal CAN-SPAM

Act requires that any unsolicited commercial e-mail messages include certain notices and an opt-out mechanism. In contrast to the notices required for unsolicited commercial e-mail, most unsolicited faxes are prohibited entirely, unless the sender has an existing business relationship with the recipient. The FTC's Telemarketing Sales Rule regulates marketing telephone calls, and in particular prohibits most unsolicited telephone calls to telephone numbers listed on the national Do Not Call Registry.

Security Interests

A consensual lien or pledge intended to secure a debt or other obligation creates a "security interest" under the applicable states' version of the Uniform Commercial Code (UCC). The secured party should perfect its security interest by filing in accordance with the UCC. To do this, notice in the form of a financing statement must be filed in the office of the Secretary of State of the appropriate state; filing generally may be performed electronically. Federal filing is required to perfect a lien against registered copyrights and may be necessary or desirable for other types of intellectual property. Care must be taken in creating a security interest to avoid jeopardizing rights in the intellectual property or creating a transfer where none is intended.

Real Estate

Purchasing real estate in most states is not particularly difficult. The differences between states, except for how and where local land records are maintained, are generally not significant. There is little regulation of real estate transactions on the federal level and,

except for environmental laws and the regulation of certain aspects of interstate land sales, the federal government does not interpose itself in local real estate transactions.

As described under the heading “Reporting Requirements for Foreign Direct Investment” on page 109, the federal government does require that certain real estate transactions be reported, but there is no regulation of, or interference in, the transactions. Generally, there are no restrictions in most states on the ability of foreign individuals or foreign business entities to acquire and hold real estate. In many states, a foreign corporation, but not a foreign individual or other foreign business entity, must file a certificate with the Secretary of State setting forth certain pertinent facts concerning the corporation and appointing the Secretary as its attorney for service of process. While a foreign corporation must comply with the forms of conveyance and procedures required in the state, its authority to make a conveyance is governed by the rules imposed upon it by the jurisdiction where it is created.

The Real Estate Transaction

The process of buying real estate involves three principal aspects: negotiation, financing, and acquisition of title, all of which are discussed briefly here.

Negotiation

Typically, a company establishing a facility or investing in real estate will either purchase or lease real estate. In either case, the first contact a company has will probably be with a real estate broker. While occasionally a buyer will hire his/her own broker, in most

cases the seller engages a broker as his/her agent to market the property to prospective purchasers. The broker's fee is computed as a percentage (usually 5 to 10 percent) of the purchase price. It is easy for the purchaser to be misled into thinking that the real estate broker has his/her best interests in mind, since he/she is the one who contacts the broker and asks to be shown the properties that are available. However, the broker is the seller's agent and in working for the seller has an obligation to generate the highest purchase price possible. There is nothing inappropriate about this, but it is wise to remember that, absent a special agreement, the broker works for the seller and his/her fee increases with the price. Once the buyer identifies a property that fits his/her requirements, he/she tenders a written Offer to Purchase to the seller through the real estate broker. Oral agreements to buy and sell real estate are not enforceable. Some purchasers prefer to submit a letter of intent, which outlines the business terms. If the seller agrees to the offer, the seller will countersign the letter. Such letters of intent are usually, by their terms, not binding on either party. The offer to purchase is binding, although it often contains a condition that the parties will negotiate in good faith a fuller, more complete contract called a Purchase and Sale Agreement that incorporates the business terms of the Offer to Purchase. The respective lawyers for the buyer and the seller usually negotiate the terms of the Purchase and Sale Agreement. In addition to including the basic business terms (location of property, purchase price, etc.), the Purchase and Sale Agreement often contains a number of conditions to the buyer's obligation to purchase the property. For example, the buyer may not want to buy if there is a hazardous waste problem, if the local zoning regulations do not permit the intended use of the

property or if he/she cannot obtain satisfactory financing. Therefore, the buyer makes his/her obligations subject to being assured that these conditions will be satisfied. The seller will expect the buyer to request conditions, but, because he/she will not want to keep his/her land off the market too long, the seller will insist that the buyer either waive the conditions or terminate the agreement within a relatively short time period. A buyer often has three to four weeks to investigate and decide whether or not to proceed with the purchase. In determining whether to buy real estate, the buyer must consider its condition and the uses to which it may be put. These questions form the basis for the conditions in the Purchase and Sale Agreement. A careful buyer will want to evaluate the condition of the land and of any buildings and improvements that are located on the land. Most buyers will have an engineering inspector assess the physical condition of the buildings and improvements. In addition, they will have an environmental consultant test the soil and the structures for the presence of hazardous waste. Due to the complexity of environmental laws (refer to the section on “Environmental Regulation” on page 76) and the very high penalties that are payable if there are violations, it is extremely important that the buyer be satisfied with the environmental condition of the premises before the purchase is completed. Under many environmental laws, liability depends not only upon fault but also upon simple ownership of the land, without regard to who caused the problem. The buyer will also want a lawyer to evaluate the zoning. Many cities and towns within a state have zoning codes or bylaws that divide the city or town into districts and establish the uses and dimensional requirements permitted in each district. For example, the town may require that

manufacturing facilities be located only in a certain area. In addition, it may require that the facility conform to height, lot coverage, setback and other dimensional requirements. The zoning code will also regulate the minimum number of parking spaces that must be provided; the location, size and design of signs; and, often, the landscaping or other decorative amenities. Where the proposed project will not conform to the requirements of the zoning code, the buyer may, if the code permits it, apply for a variance or special permit, each of which allows the buyer to do something that otherwise would not be permitted under the zoning code. In extreme cases, the buyer may ask a lawyer to apply to the town to have the property rezoned, which requires amending the zoning code.

Financing

At the same time a buyer is making these investigations, he/she may also be seeking to borrow part of the acquisition costs, unless he/she plans to pay for all of them out of his/her own funds. The most common sources for financing are commercial banks and insurance companies. For certain kinds of property, such as low-income housing, there may be some state or federal assistance available. A prospective lender will require a substantial amount of

“Generally, there are no restrictions in most states on the ability of foreign individuals or foreign business entities to acquire and hold real estate.”

information about both the buyer and the property in advance. The lender will ask for financial statements, tax returns and other financial records. The lender's counsel will investigate the title to the property and its compliance with local zoning laws. The lender will require a survey and will provide information about the property's compliance with environmental laws and regulations. If the buyer is a corporation, the lender will also require evidence that it is properly formed and has the authority to borrow and repay the money, together with a number of other documents and certificates. The loan and the promise to repay the borrowed money are set forth in a promissory note, which the buyer signs. The principal security for the repayment of the loan is a mortgage on the real estate. Some states use an instrument called a deed of trust, but others do not. By granting a mortgage to the lender, the buyer is, in effect, conveying the property to the lender as security for the repayment of the loan. Once the debt has been repaid, the lender discharges the mortgage and relinquishes its interest in the land. If the buyer defaults in the repayment of the promissory note, the lender may foreclose on its mortgage. After certain statutory notices are sent to the owner and anyone else having an interest in the property, the property is sold at a public auction. Anyone who produces the required deposit may bid, and the money received at the auction is applied to the repayment of the debt. Where the high bid is not sufficient to repay the outstanding balance of the loan, there is a deficiency, which the lender may collect by suing the owner.

Acquisition of Title

The actual transfer of title occurs at the closing. Usually the buyer, the seller, their lawyers and the lawyer for the lender all meet to put into effect the loan, the transfer of title and the payment of the purchase price. These all occur simultaneously, since the buyer will not pay the purchase price without obtaining title to the property, the seller will not transfer the title without the buyer's paying the purchase price, and the lender will not provide the buyer the money to pay the seller unless the buyer can provide a security interest in the real estate. Since title is actually transferred at the closing, the seller wants to be assured of payment in good funds. Therefore, the buyer must make arrangements in advance to have the funds available in the form of a certified check or a bank cashier's check in a bank account from which the money may be sent by wire transfer directly to the seller's bank account. At the closing, the seller delivers the deed, which is the document that actually transfers the title, to the buyer. The buyer then signs the mortgage, and the lender's lawyer takes both documents to the state's registry of deeds for recording. Prior to the closing, the lender's lawyer would have made a search of records in the state's registry of deeds to confirm that the seller actually owns the land that is being sold. After the closing, the lender's lawyer completes the search and, if there have been no other transfers or liens, records the deed and the other documents. Commercial real estate lenders now require their borrowers to purchase title insurance in connection with a loan. Prior to the closing, the lender's counsel will have searched the land records to determine who owns the property, whether there are liens that must be satisfied, whether there are any restrictions on the use of the property imposed by prior owners,

and whether anyone else has the right to use all or part of the property (an easement) in a way that would interfere with the buyer's intended use. Once the lender is satisfied that there are no problems and that the buyer now owns the property, counsel will certify the title to the title insurance company. In turn, upon payment of a one-time insurance premium, the title insurance company will issue a lender's policy, which insures the priority of the lender's security interest as a lien against the real estate, and, if the buyer pays a small additional premium, will issue an owner's policy, which insures the interest of the buyer. Should the title be other than as stated in the title insurance policy, the title insurance company will reimburse the owner and the lender to the extent of their loss but not, subject to certain exceptions, in excess of the face amount of the policy.

Leases of Real Estate

A business enterprise might prefer not to tie up its funds by purchasing real estate, or the property in which it is interested may not be available for sale. The solution would be to lease the property. The parties would negotiate and ultimately sign a lengthy and fairly complicated document, a lease, which gives the tenant the right to use the leased property; provides that the landlord is entitled to receive, in return, a set amount of periodic rental payments; and defines the other conditions under which the property may be used. If the lease is not in writing, it is not enforceable. Leases usually describe who is responsible for maintaining the property, obtaining insurance and rebuilding the property if there is a casualty loss. Simpler lease agreements, where the tenant pays rent in return for space but the landlord

manages the building, are called “space leases.” A “net lease,” on the other hand, is a lease where the tenant leases all or a substantial part of a building and is responsible for all costs — repairs, replacements, insurance, real estate taxes — connected with the building. The principle is that the rent is net to the landlord; that is to say, it is pure profit. Most commercial leases are for five- or ten-year terms, although shorter terms are available. The tenant often negotiates an option that requires the landlord, upon the tenant’s request, to extend the term of the lease if the tenant agrees to pay a new rent equal to the fair market rent for the premises. Many leases also provide that, as part of the rent, the tenant pay a proportionate share of the building’s operating costs and real estate taxes. If the landlord is in a strong negotiating position, he may also require that the tenant pay an increase in rent each year based upon increases in the Consumer Price Index (CPI) or some other economic indicator. In many retail shopping center leases, the tenant also pays percentage rent, which is computed as a percentage of sales. In some states, if a lease is longer than a set number of years, then the tenant may need to record a notice in the registry of deeds to put third parties on notice of the tenant’s interest in the real estate.

“For certain kinds of property, such as low-income housing, there may be some state or federal assistance available.”

Environmental Regulation

Environmental laws affect a wide variety of business operations and land use development projects. Regulation occurs at the federal, state and local levels, and the laws are administered by a variety of agencies and boards. The many potentially applicable laws, combined with overlapping jurisdictions of regulatory authorities, make this field of law highly specialized and replete with traps for the unwary. Because U.S. environmental law imposes strict liability for environmental problems, in contrast to the fault-based system that characterizes most U.S. law, it is particularly critical that companies remain abreast of the many regulations potentially applicable to their operations. The challenge for those doing business in the U.S. — and many companies in environmentally sensitive businesses have met that challenge and thrived — is to conduct their business in a profitable manner while taking steps to minimize potential environmental liabilities. The following discussion provides an introduction to U.S. and state environmental laws. Some apply to ongoing businesses, others only to land use development projects. Some apply regardless of whether a business uses or disposes of large quantities of hazardous substances. Each set of laws and regulations has a multitude of exemptions and exclusions, which may, if applicable, dramatically alter the financial impact of the law to a particular business or transaction. Important interpretive guidance and official policy materials may have similar effect. Reference to the appropriate statutes, regulations and guidance documents is imperative to determine their applicability to a specific situation. Consultation with competent and knowledgeable environmental counsel and technical

experts is strongly recommended. The federal Securities and Exchange Commission's rules and interpretive guidance regarding the disclosure of certain environmental matters by publicly held companies will not be discussed here.

Minimizing and Managing Risks

The stiff penalties (including fines and, in some cases, prison terms) for violations of environmental laws and the enormous cost associated with compliance with certain of these regulations and with cleanup of contaminated soil and groundwater focus attention on environmental matters for both ongoing businesses and purchasers of businesses or property. Careful planning can minimize and manage these risks. Because U.S. environmental laws have a broad liability net, a company acquiring a business or real property — and often its lender — are advised to conduct an environmental due-diligence investigation to discover whether the business has committed violations or the property is contaminated and, if so, to allocate the risks by agreement between the buyer and the seller (and sometimes the financing entity). For example, contracts could provide for indemnities or escrow accounts to fund costs of assessment and corrective action. An environmental due-diligence effort helps to ensure that the buyer's acquired assets or real property are not later devalued as a result of subsequently discovered environmental problems. Obviously, the latter problem is also of significance to the buyer's lender. An acquiring company and its legal counsel often engage an environmental consultant to assist in the due-diligence effort. In many cases, the consultant will combine a property contamination investigation with an operational compliance evaluation aimed at investigating such issues as

whether the facility or business has all necessary environmental permits and is in compliance with its permits and applicable laws, in some cases including environmental laws beyond the scope of this summary. In appropriate cases, the due-diligence investigation may include an assessment of worker safety. The market for environmental insurance has grown significantly in recent years, and a significant part of these risks can often be minimized through use of the various insurance products currently available. Finally, because the legal standards governing liabilities for successor and parent corporations — as well as the individual directors of these corporations — are in a state of flux, careful attention should be paid to business organization and structure issues in order to minimize the number of potentially liable entities.

The Key Regulatory Agencies

The Environmental Protection Agency (EPA) is the federal agency with primary responsibility for environmental matters. The EPA oversees implementation of federal laws regulating management and disposal of hazardous waste, protection of water quality and wetlands, air pollution, cleanup of contaminated properties under the Superfund statute, and other environmental issues. The EPA's main headquarters is in Washington, D.C., but considerable permitting and enforcement power is delegated to the EPA's various regional offices. The Department of Environmental Protection (DEP) implements and enforces most of a state's environmental laws, which are often, but not always, similar to federal law. The state laws are intended to supplement the federal laws, and in some areas are more stringent. In some cases, the state laws operate in lieu of the related federal scheme; in other cases, the federal and

state systems operate together. In some states, municipalities also exercise significant control over environmental issues through their conservation commissions, planning boards, zoning boards and boards of health. Cities and towns derive their authority both from local bylaws and from designated state or federal laws.

Contaminated Property: Cleanup and Liability Issues

The federal law governing identification and cleanup of property contaminated by hazardous substances is the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), popularly known as the “Superfund” law, 42 U.S.C. §§ 9601, of seq. Superfund’s impact on the business community has been enormous, largely due to the law’s broad imposition of liability without regard to fault. Under Superfund, each business that generated or disposed of hazardous substances on the property may be called to bear the cost of investigation and cleanup regardless of whether the disposal activities complied with legal requirements in effect at the time. Generally speaking, each of the responsible parties is jointly and separately liable, at least to the government, for the response costs of investigating and remediating contaminated sites. As a result, a financially healthy or “deep pocket” defendant is potentially exposed to the entire cost of site assessment and remediation. Superfund’s liability is retroactive, covering activities that occurred even before the law was adopted. The risks under Superfund are offset somewhat by incentives designed to limit or eliminate liability in certain situations. For example, the federal government offers “Brownfields” grants to help finance cleanup and redevelopment of some types of contaminated properties. In addition, through “prospective purchaser agreements,” the EPA assures lenders, owners and buyers that the

federal government will not pursue actions against properties cleaned up under state programs. In 2002, Congress passed amendments to Superfund to further encourage development of Brownfield properties. Many states have a liability and cleanup scheme similar to the federal Superfund. Most contaminated properties in many states are cleaned up under the state law, rather than under CERCLA. Some states have gone further than the federal government to encourage cleanup and redevelopment of contaminated property. Even so, they may not resolve all the concerns regarding contamination or potentially contaminated property, and potential owners, occupants or developers of real estate are well advised to carefully evaluate the environmental condition of properties they are considering for purchase or use.

Regulation of Hazardous Waste and Other Toxic Substances: “Cradle-to-Grave” Regulation of the Generation, Transport, Treatment, Storage, Recycling and Disposal of Hazardous Waste

The federal Resource Conservation and Recovery Act, 42 U.S.C. § 6901, et seq. (RCRA), is designed to help prevent the need for costly property cleanups by controlling the nation’s hazardous waste from the point of generation through its subsequent transportation, storage, treatment and disposal — or “cradle to grave.” To meet this mandate, the EPA has promulgated complex regulations to control hazardous waste (40 C.F.R. Parts 260 et seq.). Some states have also enacted their own hazardous waste regulatory schemes. Many states have designed their programs to be both broader and more stringent than the minimum federal requirements. It is the waste generator’s responsibility to determine whether or not its

waste streams are regulated under RCRA and the state law. There are two major categories of regulated hazardous waste: waste streams specifically listed by DEP (“listed wastes”), such as wastewaters from electroplating operations, and wastes that exhibit one or more of the characteristics of toxicity, ignitability, reactivity or corrosivity (“characteristic wastes”). A state law’s listed wastes may encompass not only materials regulated by the federal RCRA, but also additional materials such as used oil, certain PCB-containing wastes and hazardous wastes that are being recycled.

“Keep in mind that even a material not formally classified as a hazardous waste may require special handling and disposal.”

Some other waste categories may be exempt from state regulation. Once material has been identified as a regulated hazardous waste, the generator is subject to various waste management requirements, depending on the amount of hazardous waste generated in any given month. These restrictions include the time period during which the waste may be stored without a permit; the manner in which it must be drummed and labeled; the paperwork documenting its transportation, storage and disposal by licensed facilities; and prohibitions against its disposal in landfills. State regulations may also contain a number of specialized provisions that address either particular types of operations or particular waste streams. Keep in mind that even a material not formally classified as a hazardous waste may require special handling and disposal. These materials include asbestos, medical waste and materials from contaminated site cleanup that are not otherwise considered hazardous waste. Finally, different regulations apply to transporters

of hazardous waste and to owners and operators of landfills and hazardous waste treatment, storage and disposal facilities.

Regulation of Toxic Substances

Apart from the “cradle-to-grave” hazardous waste programs outlined above, other laws regulate the production, use and disposal of so-called toxic substances, even if they are not wastes. Among the substances that the federal government regulates under the Toxic Substances Control Act (TSCA), 15 U.S.C. § 2601 et seq., and regulations issued at 40 C.F.R. Part 761, are polychlorinated biphenyls (PCBs). The TSCA also regulates the introduction of certain new chemicals into the marketplace.

Asbestos

Asbestos was commonly used in building products and in industry until the late 1970s and must be handled carefully when buildings are renovated or demolished. Asbestos is regulated by a variety of federal and state laws, including the federal Clean Air Act, which defines asbestos as a hazardous air pollutant. The Occupational Safety and Health Administration (OSHA) has promulgated rules governing occupational exposure to asbestos. These rules mandate that increasingly stringent controls and work practices be applied to each of four classes of increasingly hazardous activity, and require employers to inform employees of the presence and location of building materials that are presumed to contain asbestos (PACM) as well as confirmed asbestos-containing materials (ACM), unless the building was built or renovated after 1979.

Underground and Aboveground Storage Tanks

A number of federal and state statutes and regulations impose a variety of requirements on the owners and operators of underground and aboveground storage tanks used to contain flammable substances, hazardous substances or hazardous wastes. These myriad requirements govern notification of a tank's presence and regulate tank installation and operation; reporting of releases, spills and leaks; cleanup of associated contamination; and financial responsibility requirements for tank owners and operators. The federal laws include the Resource Conservation and Recovery Act, previously discussed, and the federal Clean Water Act. In some instances, state law may impose stricter requirements on tank owners than do the federal regulations.

Water Pollution Control

NPDES Permits and Wastewater Pretreatment Requirements

Several federal and state laws are intended to prevent or limit the discharge of pollutants into surface waters. The most notable of these is the federal Clean Water Act, 33 U.S.C. § 1251 et seq. The federal and state programs operate coextensively. In general, specified categories of industrial dischargers are subject to technology-based effluent standards established by the EPA. National Pollutant Discharge Elimination System (NPDES) permits are issued to individual industrial dischargers for direct discharges of their process wastewaters and other designated noncontact waters to surface waters. Indirect discharges of effluent to municipal or other publicly owned treatment works (POTWs) are regulated through industry-specific, as well as generally applicable,

pretreatment standards, which must be met prior to the discharge of effluent to a POTW. Typically, new point sources of such discharges are regulated more stringently than existing sources. Discharges to groundwater may be regulated by state water quality programs to ensure that state-mandated groundwater quality standards are maintained. Storm water runoff associated with industrial activities and construction sites is also regulated under federal and state clean water acts. Under EPA regulations, a facility may need a site-specific permit, issued in a manner similar to the basic NPDES program. However, in many cases, facilities will be eligible for coverage under a general permit issued by the EPA. To be covered by a general permit, a facility must submit a Notice of Intent (NOI) in order to be covered by the permit, to develop and implement storm water pollution prevention plans, and to conduct site inspections. The general permits do not authorize mixed or non-storm water discharges, nor do they exempt permittees from spill notification requirements in the event of a release of hazardous substances into a discharge. The permit for discharges associated with industrial activities requires quarterly monitoring for certain types of facilities.

Air Pollution Control

An overlapping system of federal and state laws is designed to limit the emission of airborne pollutants from industrial facilities. The air pollution control programs discussed in this summary concern facilities that are known as stationary sources.

The federal and state programs also extensively regulate mobile sources of air pollutants, such as automobiles. The federal and

state regulatory scheme governing air pollutants is exceedingly complex, particularly for larger sources of air pollution. A wide variety of air pollutants are regulated. Six air pollutants are subject to National Ambient Air Quality Standards (NAAQS): sulfur dioxide, carbon monoxide, ozone, nitrogen dioxide, lead and particulate matter. In addition to standards for these “criteria” pollutants, the EPA is continuing to develop standards for hazardous air pollutants (HAPs). Some states are also paying increasing attention to carbon dioxide and other so-called greenhouse gas emissions (though the regulation of carbon dioxide is still in the earliest stages), and to noise pollution. It is important to recognize that a wide variety of new sources require air permits, and that those permits must be in place before construction can begin on those sources. Obviously, air permits are required for major generators of air emissions, such as power plants, but they can also be required for much smaller sources, including emergency backup generators, laboratory operations and heating boilers. Most air permits are issued by state agencies, but the EPA often participates in the permitting process. The EPA and state agency must both issue an approval for new major sources of air pollution. A variety of regulatory programs can apply to individual sources. A Prevention of Significant Deterioration (PSD) permit must be obtained from the EPA before a major source of regulated air pollutants is constructed or modified in a significant manner. Under certain circumstances, these large sources also must obtain approvals from the applicable state agency under the New Source Review program, which requires the most stringent emission control technology and often requires the purchase of emission “credits” from other sources to offset the new emissions created by the new source.

The New Source Performance Standards program (NSPS) imposes technology-based limitations on designated types of new facilities or industrial operations. Large sources of hazardous air pollutants are subject to the other programs in order to achieve Maximum Achievable Control Technology (MACT) standards. Finally, large sources of air pollutants are also required to obtain an operating permit. Basically, the operating permit program works to collect, in one permit for each regulated facility, all the various air pollution control requirements applicable to that facility.

Community “Right-to-Know”: Mandated Information Disclosure

The federal Emergency Planning and Community Right-to-Know Act (EPCRA) was enacted primarily in response to the 1984 Bhopal chemical release disaster. (EPCRA is similar to the European Community’s Seveso Directive, the Directive on Major Accident Hazards of Certain Industrial Activities, 82/501 [OJ L 230, June 24, 1982], as amended by Directives 87/216 [OJ L 85, March 28, 1987] and 88/610 [OJ L 336, December 7, 1988].) Businesses covered by EPCRA are generally required to notify state and local emergency planning entities of the identities and quantities of regulated hazardous chemicals and toxic chemicals that are used or kept at their facilities or are released to the environment. Notification is by annual filing of Material Safety Data Sheet (MSDS) forms or chemical lists, inventory reports, and toxic chemical release reports. EPCRA also requires regulated businesses to immediately notify federal, state and local authorities of accidental releases of hazardous chemicals.

Toxic Substance Use Reduction

The federal government and many states are increasingly providing industries with incentives and mandates to reduce the use of toxic chemicals in industrial processes. The Pollution Prevention Act of 1990 (PPA), 42 U.S.C. §§ 13101 et seq., makes pollution prevention or reduction at the source a national policy and directs the EPA to promote source-reduction activities. Owners and operators of facilities required to file toxic chemical release reports under EPCRA are required to include toxic chemical source-reduction and recycling information that is then made available to the public. The EPA uses the industry-provided information to identify future pollution prevention opportunities.

Development and Construction Projects

Much of the preceding has focused on requirements that most often apply to larger industrial or commercial facilities or contaminated properties. However, there are a host of federal and state laws that apply more broadly to the development, construction and expansion of facilities, regardless of whether those facilities generate wastes, emit pollutants or lie on contaminated land. In addition to conventional land use and zoning laws, which are primarily administered at the local level, there may also be state statutory and regulatory frameworks relevant to project development. Land use development projects are often subject to legal challenges by project opponents.

The National Environmental Policy Act, which requires development of Environmental Impacts Statements (EISs) for major federal projects, may significantly affect the environment. Some states may have a similar law.

Wetlands Protection and Coastal Zone Management

The federal Clean Water Act regulates the discharge or placement of dredged or fill material into federally protected “navigable waters.” A permit from the U.S. Army Corps of Engineers (Section 404 Permit) is required for most discharges of dredge or fill material. “Waters of the United States” include most wetland areas; “waters” and “wetlands” have been broadly interpreted. This interpretation gives the Corps of Engineers, and often the EPA, a significant regulatory role in development projects in or near federal wetland areas. However, in 2001, the Supreme Court narrowed federal government jurisdiction under Section 404, in a ruling that concluded that isolated wetlands are not waters of the United States. A 2006 Supreme Court decision has created further uncertainty regarding the need for Section 909 permits for some wetlands. States may also have state laws regarding wetlands protection. It is also worth noting that cities and towns may have authority under state law to enact their own wetlands bylaws. Therefore, a developer should determine whether a city or town has its own bylaws and whether they may be more stringent than the state regulations. Either way, the developer will apply first to the local conservation commission for approval.

“The federal Clean Water Act regulates the discharge or placement of dredged or fill material into federally protected ‘navigable waters.’ ”

A Note About Environmental Litigation

Any summary of U.S. environmental law would not be complete without mentioning the important role of environmental litigation both in enforcing the various laws and in reimbursing injured parties for legally compensable injuries. In addition, it is important to recognize the impact of challenges to environmental permits in the overall project development process. Actions to establish liability for cleanup costs, as well as penalties for violations, can be brought in both federal and state courts under many of the environmental statutes described in this summary. Many of these statutes not only provide for suits by governmental agencies, but also allow other private parties — such as landowners, other affected persons or concerned citizens — to sue to enforce legally established environmental law requirements. In addition, certain statutes and the common law of some states allow private parties to sue for property damages (which may include the reduced value of land) and injunctive relief in many situations involving environmental contamination of land, water or air. A state's common law may also allow suits for personal injuries caused by exposure to toxic or otherwise harmful substances. Potential causes of action (e.g., theories of liability) may include claims of negligence, trespass and nuisance. Recently, there has been increasing litigation activity relating to indoor air pollution and mold, which are not pervasively regulated under existing environmental law. The normal rule throughout the United States is that each party to litigation pays its own attorneys' fees, win or lose; the victor's litigation expenses are not ordinarily reimbursed by the loser. However, under some environmental statutes, the loser is required to pay the winner's attorneys' fees, especially in suits brought by citizens' groups or

where the loser is shown to have unreasonably failed to acknowledge its legal responsibilities. Apart from litigation relating to environmental compliance or responsibility for cleanup costs, most of the permits and approvals discussed in this section can be appealed by the party that applied for the permit and by other aggrieved parties. Many of the regulatory programs require the initial appeal of a permit or approval to be filed with an administrative agency rather than in court, though judicial appeal is ultimately available. Appeals can be costly and time-consuming, and in many instances the project cannot proceed until the appeals have run their course.

Taxation

Federal Taxation

United States taxation of business income earned by a foreign investor can produce significantly varied results, depending upon the form, nature and extent of the investor's activities in the U.S. The following is a general overview of the potential federal tax consequences resulting from different methods of business operation in the United States.

The Residency Rules

The United States subjects all U.S. tax residents to net progressive rate taxation on their entire worldwide income, regardless of source. Nonresidents, however, are subject to U.S. tax only on

income derived from U.S. sources. Moreover, nonresidents pay only a flat 30 percent withholding tax on most U.S.-source passive income. Finally, qualified residents of countries with which the U.S. has tax treaties can take advantage of treaty provisions to reduce, or even eliminate, U.S. taxation. Therefore, from a tax perspective, foreign individuals and corporations will generally find it advantageous to avoid U.S. tax residency.

Tax Residency for Corporations and Partnerships

Corporations and partnerships are treated as United States tax residents (that is, “domestic” entities) only if they are formed under the laws of the United States, any one of the states or the District of Columbia. Thus, investors operating in the corporate or partnership form are assured of foreign status so long as the corporation or partnership is formed outside the United States.

Tax Residency for Individuals

A foreign individual who possesses a “green card” granting him or her permanent residency in the United States is automatically a U.S. resident for federal income tax purposes. An individual who does not have a green card may also be a U.S. tax resident if he/she spends sufficient time in the United States to have a substantial presence here. Substantial presence is calculated on a modified day-count basis.

United States Income Taxation of Nonresident Foreign Investors

In general, a foreign investor who is not a U.S. tax resident is subject to U.S. taxation only on U.S.-source income. The taxation of U.S.-

source income depends on whether the income is considered “fixed or determinable, annual or periodic” (FDAP) income, or income that is “effectively connected” with a U.S. trade or business (ECI).

Passive or FDAP Income

Most U.S.-source passive income — such as dividends, interest, rent, royalties and annuities — is FDAP income, that is, fixed or determinable, annual or periodic. FDAP income is not subject to U.S. net progressive taxation. Rather, the gross amount of FDAP income is subject to a flat 30 percent withholding tax. A taxpayer who is a qualified resident of a country with which the United States has a tax treaty may be able to reduce this tax rate to 5 to 15 percent in the case of dividends, and in some cases eliminate tax completely for interest or royalties. There are three important exceptions to the general rule that passive income is taxed as FDAP income. First, passive income that is effectively connected with the foreign investor’s conduct of a U.S. trade or business is not taxed as FDAP income, but rather as ECI, as described below. Second, income from the sale of a United States real property interest is also taxed as ECI rather than FDAP income (see the discussion under the heading “Income Derived from the Disposition of U.S. Real Property Interests” on page 95). Third, gains from the sale of capital assets (such as corporate stock) are not FDAP income. Thus, capital gains are generally not subject to United States taxation unless they are ECI or the capital asset sold is a U.S. real property interest.

Effectively Connected Income (ECI)

U.S.-source income earned by nonresident individuals and entities is subject to the net progressive federal income tax if it is effectively

connected with the conduct of a United States trade or business. Importantly, a foreign investor who engages in the conduct of a U.S. trade or business must file U.S. federal and state income tax returns; a foreign investor who has only FDAP income is generally not required to file returns.

The first step in analyzing whether U.S.-source income is ECI is to determine whether the nonresident individual or entity is engaged in the conduct of United States trade or business. Relevant factors include the level, nature, continuity and regularity of the foreigner's activities in the United States. The activities of a U.S. agent (whether dependent or independent) are attributed to a foreign principal in this context. If the activities involved rise to the level of a trade or business, the second step is to determine whether the income in question is effectively connected with the conduct of that trade or business. This analysis can often be quite complicated, since there is no requirement that the income be a direct product of the trade or business in order for it to be deemed effectively connected income. For example, assume that a foreign corporation operates a branch that conducts a trade or business in the United States. The corporation invests a portion of its branch earnings in the stock of a large, but unrelated, U.S. corporation. It later sells the stock at a significant profit and reinvests the profits in its branch business in the United States. Even though the corporation's income from the stock sale is clearly not derived directly from the conduct of its U.S. branch business, this income is treated as effectively connected with the conduct of its U.S. trade or business. This result is particularly significant because capital gains are not FDAP income; if the gain from the stock sale is not ECI, it will attract no U.S. tax at all, even if repatriated to the foreign corporation. ECI can be active

or passive income. Thus, a dividend received by a foreign investor from a U.S. corporation would normally be FDAP income and therefore taxed (withheld) at the flat rate of 30 percent. If the dividend were ECI, however, it would be taxed at rates as high as 35 percent for corporate investors and 39.6 percent for individual investors. Since ECI taxation is based on net income, however, applicable deductions may be taken against the gross amount of the income (for example, the dividend-related deduction may be available to the corporate investor). As with FDAP income, treaties can significantly affect the tax treatment of effectively connected income. Under the model treaty upon which most U.S. tax treaties are based, effectively connected income can be taxed under the normal progressive rate structure only if the income is attributable to a permanent establishment maintained by the foreign investor in the U.S. A permanent establishment requires a greater level of activity than a trade or business, usually involving the existence of a fixed presence in the U.S., such as a factory, store, office or other place of management.

Income Derived From the Disposition of U.S. Real Property Interests

Foreign entities and individuals that own United States real property interests are subject to the Foreign Investment in Real Property Tax Act (FIRPTA), which automatically treats income realized upon a sale of a United States real property interest as effectively connected income. United States real property interests include direct ownership of real property located in the U.S. and any interest in a domestic corporation that is a U.S. Real Property Holding Company (USRPHC). A domestic corporation is a USRPHC if more than 50

percent of its business assets consist of U.S. real property interests. United States tax laws offer the foreign taxpayer an irrevocable election to treat all income derived from a U.S. real property interest — not merely sale income automatically treated as ECI — as effectively connected to the conduct of a United States trade or business, whether or not the taxpayer is, in fact, engaged in such a trade or business. Since FIRPTA will automatically treat the income from the sale of the property as effectively connected income, taxpayers subject to FIRPTA may find it advantageous to make this election, thereby allowing them to offset income derived from the property with the costs of producing such income. If the election is not made, rental or other income derived from the property will generally be FDAP income against which no deductions are allowed, yet any gain realized upon disposition of the property will be ECI under FIRPTA and thus fully taxable.

Sourcing Rules

With certain minor exceptions, the United States will impose taxes only on a foreign individual's or entity's U.S.-sourced income. Therefore, the sourcing of a foreign investor's income is crucial to any analysis of its potential U.S. tax liability.

Sales of Personal Property

Generally, the source of gains from the sale of personal property is the tax residence of the seller. Thus, if the seller is not a United States tax resident, any gains from the sale of personal property, including corporate stock, will be sourced outside the U.S., even though the sale may take place within the U.S. Sales of inventory,

depreciable personal property and intangibles, however, do not fall under this general rule and instead have their own particular sourcing provisions.

Sales of Real Property

Gain on the disposition of real property is sourced at the property's location. Thus, if the property is located in the United States, any gain from its sale would be U.S.-sourced and automatically ECI under the FIRPTA provisions.

Other Sourcing Provisions

Interest and dividends are generally sourced at the residence of the distributing bank, corporation or other payer. Rental and royalty income is sourced at the location of the property that is the subject of the lease or license.

Methods of Business Operation and Repatriation of Earnings

The method by which earnings and profits of a U.S. business can be repatriated is a major concern of the foreign entity or individual doing business in the United States. The tax implications of operating a business through a branch, as opposed to a corporate subsidiary, can be significant.

The Branch Operation

In order to minimize the tax differences between doing business in the United States through a corporate subsidiary as opposed to operating through a U.S. branch office, the United States has

instituted a “branch profits” tax. This operates as a second-level tax, similar to the tax imposed on dividends paid by a subsidiary corporation. Therefore, in addition to the normal first-level net progressive tax levied on the branch’s profits as effectively connected income, a flat 30 percent tax is also imposed on those same profits (reduced by the first-level tax already paid), but only to the extent that the profits are not reinvested in the U.S. branch’s business. While the effect of this tax is similar to that of the tax imposed on dividends paid by a subsidiary corporation, a major difference does exist. That is, both the first-level tax on effectively connected income and the second-level branch profits tax are imposed at the corporate level. If a subsidiary corporation is used instead of a branch, however, the first-level tax is imposed at the corporate (subsidiary) level, while the second-level dividend tax is imposed at the stockholder level.

Arguably, this double tax at the corporate level discriminates against foreign corporations doing business in the United States, as domestic corporations are subject to only one tax at the corporate level. Therefore, if the foreign corporation is a qualified resident of a country with which the United States has an income tax treaty, and such treaty contains a valid nondiscrimination clause, the foreign corporation will be fully exempt from the branch profits tax when it repatriates its earnings from its branch to its home office in a foreign country.

The United States has income tax treaties containing effective nondiscrimination clauses with the following countries: Aruba,

Austria, Belgium, Cyprus, Denmark, Egypt, Finland, Germany, Greece, Hungary, Iceland, Ireland, Jamaica, Japan, Korea, Luxembourg, Malta, Morocco, Netherlands, Netherlands Antilles, Norway, Pakistan, People's Republic of China, Philippines, Sweden, Switzerland and the United Kingdom. Unfortunately, certification requirements prevent a privately held company from easily demonstrating that it is a qualified resident under most of these treaties. Accordingly, unless an overriding foreign tax goal exists or the foreign corporation's business mandates the use of a U.S. branch, consideration should be given to incorporating a U.S. subsidiary.

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The Corporate Subsidiary Operation

Foreign corporations may find it beneficial to do business in the U.S. through a domestic corporation. The corporate subsidiary form of doing business offers the foreign investor many tax advantages over the branch form, including greater flexibility with respect to the repatriation of earnings and profits. The first advantage offered by the corporate subsidiary form is avoidance of the branch tax discussed above. Whereas the branch tax is automatically imposed on the branch's earnings and profits that are not reinvested in the United States business for any given year, the foreign parent of a United States corporate subsidiary will not be exposed to a second

level of United States tax until the subsidiary actually distributes its earnings and profits to its foreign parent. A second advantage to the U.S. subsidiary corporation concerns the lower withholding rates available through tax treaties on dividends received by foreign corporations from their U.S. subsidiaries. As mentioned earlier, qualified residents of countries with which the United States has income tax treaties can have their FDAP withholding rates reduced from 30 percent to as low as 5 percent if the parent corporation owns at least 10 percent of the U.S. subsidiary, and to 15 percent in all other cases. No such withholding reduction is available against the branch profits tax. Doing business in the United States through a corporate subsidiary also allows a foreign corporate investor to finance its investment through debt rather than equity. Debt financing can present many advantages over equity financing. For example, many U.S. tax treaties reduce FDAP withholding rates on interest beyond the reductions available for dividends (ranging from no interest in some cases to 5 percent or 15 percent on dividends discussed above). The greatest advantage afforded through debt financing is that interest payments made by the U.S. subsidiary are deductible, while dividend payments are not. The United States, however, has sharply curtailed the availability of these interest deductions through the enactment of earnings-stripping rules. Under these rules, U.S. corporations paying interest to foreign related parties may be denied, in whole or in part, a deduction for such payments.

Four conditions must be met before these earnings-stripping limitations are triggered. First, the U.S. corporation paying the interest must be related to the foreign recipient of the interest payments. Under United States tax law, the foreign recipient and

U.S. subsidiary are related if the foreign parent corporation owns more than 50 percent of either the vote or value of the subsidiary corporation's outstanding stock. Second, the earnings-stripping rules apply only to the extent that the foreign recipient is exempt from U.S. withholding tax on the interest income under an income tax treaty.

For example, if the applicable treaty reduces the U.S. withholding tax on interest to 10 percent from the FDAP withholding rate of 30 percent, two-thirds of the interest paid will be deemed exempt from U.S. withholding tax and thus subject to the earnings-stripping limitations. Third, the subsidiary must be thinly capitalized, which means that its debt-to-equity ratio must exceed 1.5 to 1. Finally, the subsidiary must have "excess interest expense"; that is, the subsidiary's net interest expense (interest expense offset by interest income) must be greater than 50 percent of its adjusted taxable income. The earnings-stripping rules deny the subsidiary corporation an interest deduction to the extent of its excess interest expense. A disallowed deduction may be carried forward indefinitely and deducted in a future year to the extent the subsidiary does not exceed the earnings-stripping limitations in the future year.

The earnings-stripping limitations present some potential traps for the unwary foreign investor attempting to maximize the advantages of debt financing over equity financing. First, the debt-to-equity ratio rule limits the usefulness of debt financing in producing interest deductions for repatriation payments. Second, the earnings-stripping limitations can apply not only to debt owed by the subsidiary to a foreign parent but also to debt the subsidiary owes to an unrelated bank lender, if that debt is guaranteed by the foreign

parent corporation. Even a simple assurance of repayment by the foreign parent may trigger this rule.

Transfer Pricing Rules

A foreign corporation with a United States subsidiary will inevitably conduct a variety of transactions with that subsidiary, such as loans of money, personal and real property transactions, and performance of services. These transactions present the possibility of significant U.S. tax avoidance through pricing practices. For example, a foreign parent incorporated in a country with lower tax rates than those of the United States may try to sell inventory to its subsidiary distributorship in the U.S. at an artificially inflated price in order to minimize the subsidiary's U.S. tax liability on sales of the inventory. In order to curb this kind of U.S. tax avoidance, the United States has enacted transfer pricing rules. These rules allow the U.S. Internal Revenue Service (IRS) to reapportion income and deductions between the U.S. subsidiary and its foreign parent if it determines that they have not conducted their transactions in an arms-length fashion, that is, in a manner consistent with the commercial practice of unrelated parties. In the past, the IRS has experienced difficulties enforcing the transfer pricing rules because of a perceived "information gap" in obtaining foreign parent business records. In response to this, the United States now imposes potentially burdensome information-reporting and record-keeping requirements on foreign-owned corporations, supported by substantial monetary and other penalty provisions to ensure compliance. Foreign investors who own U.S. business operations should pay careful attention to these information-reporting and record-keeping rules.

State Taxation

In addition to federal taxation, each state has its own tax regime, which generally includes a personal income tax, a sales tax and a corporate tax. Local cities and towns may also assess taxes.

Antitrust and Trade Regulation

Both the U.S. and many states have enacted extensive laws and regulations aimed at preventing and punishing unreasonable restraints on free trade, monopolistic practices and unfair competition. Generally, transactions that involve commerce in more than one state and international commerce are governed by federal laws. However, a state's unfair-competition law can be invoked in areas in which federal law does not govern or to provide remedies beyond those available under federal law.

Federal Law

U.S. antitrust laws include the Sherman Act, the Clayton Act and the Robinson-Patman Act. The Sherman Act prohibits contracts, combinations and conspiracies that unreasonably restrain trade. Certain restraints on trade, most notably price-fixing agreements among competitors, are "per se" unreasonable. Certain other restraints, for example controls placed by manufacturers on the sales activities of distributors, are usually governed by the "rule of reason," in which the procompetitive and anticompetitive effects of the activity are weighed against each other. The Sherman Act also prohibits monopolization, attempted monopolization and conspiracies to monopolize. The U.S. government may bring both criminal prosecutions and civil lawsuits to enforce the Sherman Act.

The Sherman Act can apply to wholly extraterritorial conduct if that conduct is intended to and does have a substantial effect in the U.S. The Clayton Act prohibits certain specific anticompetitive activities. For example, it prohibits a seller with market power in one product from forcing a customer to buy a second product in order to purchase the first product, so-called tying. It also prohibits mergers and acquisitions that would tend to lessen competition in a given area of commerce. The Robinson-Patman Act prohibits discrimination and inducing others to discriminate in the price charged for commodities of “like grade and quality” to competing buyers, and certain discriminatory advertising allowances, brokerage payments and services rendered in connection with the purchase of goods. Given the complexity of the law in these areas, potential violations of the Clayton Act and Robinson-Patman Act must be assessed on a case-by-case basis. The U.S. government has the power to enforce both acts through either the Justice Department or the Federal Trade Commission (FTC). Private individuals and corporations that are injured by violations of the U.S. antitrust laws, including the Sherman Act, Clayton Act or the Robinson-Patman Act, may sue for injunctive relief, three times their actual damages and their attorneys’ fees (15 U.S.C. § 15). Companies seeking to engage in certain cooperative research, development or production joint ventures may apply to the Department of Justice and the FTC and may, under the proper circumstances, obtain an exemption from liability for treble damages and attorneys’ fees. U.S. antitrust policy is also promoted through the Federal Trade Commission Act and the Hart-Scott-Rodino Antitrust Improvements Act of 1976. The FTC Act is intended to protect U.S. consumers, domestic industry and

exporters from “unfair methods of competition” and “unfair or deceptive arts or practices.” The FTC has broad authority to determine what constitutes an unfair method of competition or an unfair trade practice. U.S. courts have upheld FTC cease-and-desist orders that enforce antitrust laws and similar policies (for example, orders relating to mergers, acquisitions and joint ventures), and orders that prohibit false representations about products and other similar practices. Under appropriate circumstances, the FTC will issue advisory opinions as to whether a particular business policy would violate the FTC Act. The Hart-Scott-Rodino Act requires that companies proposing to acquire companies that do business in the U.S. or assets located in the U.S. must, under certain circumstances, report such proposals to the FTC and the Justice Department prior to the acquisition. Whether reporting is required depends on a formula related to the size of the acquiring company and the size of the assets being acquired. Failure to report may lead to fines of up to \$11,000 per day. The current nonrefundable filing fee is \$45,000 to \$280,000, depending on the size of the transaction. It must be paid by the acquiring party for each proposed transaction to which Hart-Scott-Rodino applies. Like the FTC Act, Hart-Scott-Rodino may be enforced only by the U.S. government.

Practical Applications

Even among U.S. lawyers, antitrust is regarded as a particularly complex area of the law. As a rule of thumb, upon entering the U.S. market, foreign companies with market power in a given area of commerce should have the structure of their proposed U.S. activities reviewed for antitrust compliance by an experienced attorney. Companies that have market power through ownership of

patents, copyrights or unique trade secrets should be particularly aware of the relationship between the intellectual property and antitrust laws, in that the use of intellectual property rights to enhance a company's market power in other areas of commerce may, under certain circumstances, result in forfeiture of those intellectual property rights and civil liability. Agreements with competitors and agreements with suppliers and vendors that affect competition should also be carefully reviewed. For example, certain communications among competitors that are legal abroad may be prohibited in the U.S.

The FTC's presale disclosure rule, 16 C.F.R. § 436, applies to offers or grants of franchises. Generally speaking, this rule requires that a franchisor provide potential franchisees with certain prescribed disclosure documents; that the documents be provided at the prescribed time; and that the franchisor abide by rules concerning representations and claims about the actual or potential sales, income, or profits of existing or proposed franchise operations. Many states also require all franchisors to register disclosure documents with state authorities. Companies engaged in business and asset acquisition (including exclusive patent licenses) should ascertain whether they need to do a Hart-Scott-Rodino filing. Joint venturers engaged in cooperative research, development and production might wish to register with the Justice Department. With respect to unfair competition laws, particularly until a company becomes familiar with local business practices, it may wish to seek legal advice about the legality of marketing and selling techniques that have a direct impact on competitors or consumers. For example, U.S. law may require disclosure of certain facts by the seller to the buyer about property being sold prior to completion of

the sale. Failure to provide full disclosure of the appropriate information may subject the seller to treble damages for an unfair trade practice.

Regulation of International Trade and Investment

Foreign investment in the U.S. and other international commercial activities involving U.S. entities are subject to a number of U.S. statutes and related regulations. The following discussion outlines some of the more important aspects of these laws, which might be relevant to someone investing in or trading with entities located in the U.S.

Restrictions on Foreign Investment

Under a statutory provision commonly referred to as the Exon-Florio Amendment (50 U.S.C. app. § 2170), the President has broad authority to investigate and prohibit any merger, acquisition or takeover by or with foreign persons that could result in foreign control of persons engaged in interstate commerce. If the President determines that such merger, acquisition or takeover constitutes a threat to national security, the United States Congress has indicated that the term “national security” is to be interpreted broadly and that the application of the Exon-Florio Amendment should not be limited to any particular industry. The statute sets out a timetable for investigations of transactions, which can take up to 90 days to complete. The President or his designee has 30 days from the date of receipt of written notification of a proposed (or completed)

transaction to decide whether to undertake a full-scale investigation of the transaction. The President has delegated his authority to make investigations pursuant to the Exon-Florio Amendment to the Committee on Foreign Investment in the U.S. (CFIUS), an interagency committee made up of representatives of various departments of the executive branch. Notifications of transactions are not mandatory and may be made by one or more parties to a transaction or by any CFIUS member agency. If, at the end of the initial 30-day period after notification of a transaction, CFIUS decides that a full-scale investigation is warranted, it then has an additional 45 days to complete this investigation and make a recommendation to the President with respect to the transaction. The President then has 15 days to decide whether there is credible evidence that leads him to believe that the foreign interest exercising control might take action to impair national security. If the President makes such a determination, Exon-Florio empowers him to take any action that he deems appropriate to suspend or prohibit the transaction, including requiring divestment by the foreign entity if the transaction has already been consummated. U.S. law also places certain restrictions on acquisitions of businesses that require a facility security clearance in order to perform contracts involving

“The FTC Act is intended to protect U.S. consumers, domestic industry and exporters from ‘unfair methods of competition’ and ‘unfair or deceptive arts or practices.’”

classified information. Under Department of Defense regulations, foreign ownership may cause the department to revoke a security clearance unless certain steps are taken to reduce the risk that a foreign owner will obtain access to classified information (DOD 5220.22-R, Industrial Security Regulation). Assuming that a foreign owner will be in a position to effectively control or have a dominant influence over the business management of the U.S. firm, the Department of Defense may require, as a condition for continuation of the security clearance, that the foreign owner establish a voting trust agreement, a proxy agreement or a special security agreement approved by the department and designed to preclude the disclosure of classified information to the foreign owner or other foreign interests (see DOD 5220.22-M, National Industrial Security Program Operating Manual).

Reporting Requirements for Foreign Direct Investment

All foreign investments in a U.S. business enterprise that result in a foreign person owning a 10 percent or more voting interest (or the equivalent) in that enterprise are required to be reported to the Bureau of Economic Analysis, a part of the U.S. Department of Commerce. Pursuant to the International Investment Survey Act of 1976 (22 U.S.C. §§ 3101–3108) and the regulations promulgated thereunder (15 C.F.R. § 806), such reports must be made within 45 days after the investment transaction. Depending on the size of the entity involved, quarterly, annual or quinquennial reports may be required thereafter.

The International Investment Survey Act of 1976

The International Investment Survey Act of 1976 (IISA) authorizes the President to collect information and conduct surveys concerning

the nature and amount of international investment in the U.S. The IISA's primary function is to provide the federal government with the information necessary to formulate an informed national policy on foreign investments in the U.S. It is not intended to regulate or dissuade foreign investment, but is merely a tool to obtain the data necessary to analyze the impact of such investments on U.S. interests. Under the IISA, international investments are divided into two classifications — direct investments and portfolio investments. Congress has delegated its authority to collect information on both types of international investments to the President. In turn, the President has delegated his power to collect data on direct investments to the Bureau of Economic Analysis (BEA), a part of the Department of Commerce, and on portfolio investments to the Department of the Treasury. A “foreign person” is any person who resides outside the U.S. or is subject to the jurisdiction of a country other than the U.S. A “direct investment” is defined as the ownership or control, directly or indirectly, by one person of 10 percent or more of the voting securities in any incorporated U.S. business enterprise or an equivalent interest in an unincorporated business enterprise. Because the IISA further defines “business enterprise” to include any ownership in real estate, any foreign investor’s direct or indirect ownership of U.S. real estate constitutes a direct investment and falls within the requirement that reports be filed with the BEA. Unless an exemption applies, a report on Form BE-13 must be filed with the BEA within 45 days of the date on which a direct investment is made. The form collects certain financial and operating data about the investment, the identity of the acquiring entity and certain information about the ultimate beneficial owner. In addition, Form BE-14 must be filed by any U.S. person assisting in a transaction that is reportable under Form BE-13

unless a Form BE-13 causing such transaction is already being filed. The purpose is, obviously, to ensure that those required to file a Form BE-13 do so.

The Agricultural Foreign Investment Disclosure Act of 1978

The Agricultural Foreign Investment Disclosure Act of 1978 (7 U.S.C. §§ 3501–3508, AFIDA) requires all foreign individuals, corporations and other entities to report holdings, acquisitions and dispositions of U.S. agricultural land. AFIDA contains no restrictions on foreign investment in U.S. agricultural land and is aimed only at gathering reliable data from reports filed with the Secretary of Agriculture to determine the nature and magnitude of this foreign investment.

Unlike the reports filed under the International Investment Survey Act of 1976, reports filed under AFIDA are not confidential but are available for public inspection. For the purposes of AFIDA, a “foreign person” is (1) any individual who is not a citizen or national of the U.S. and who is not lawfully admitted to the U.S.; (2) a corporation or other legal entity that is organized under the laws of a foreign country or has its principal place of business outside the U.S.; (3) a corporation or other legal entity organized in the U.S. in which a foreign person, either directly or indirectly, holds 10 percent or more of an interest; or (4) a foreign government. The definition of “agricultural land” is any land in the U.S. that is used for agricultural, forestry or timber production. AFIDA requires a foreign person to submit a report on Form ASCS-153 to the Secretary of Agriculture any time he/she holds, acquires or transfers any interest, other than a security interest, in agricultural land. The report requires rather detailed information concerning such matters as the identity and country of organization of the owning entity, the nature of the

interest held, the details of a purchase or transfer, and the agricultural purposes for which the foreign person intends to use the land. In addition, the Secretary of Agriculture may require the identification of each foreign person holding a 10 percent or greater interest in the ownership entity.

Export Controls

In general, U.S. export controls are more stringent and govern a wider array of transactions than the export controls of most other countries, even with respect to nonmilitary “dual-use” commodities and technology. (See the regulations originally promulgated under the Export Administration Act of 1979, as amended, at 15 C.F.R. §§730–799.) Except for exports to U.S. territories and possessions, exports from the U.S. may be subject to an export license. An export license is a government authorization that allows the export of particular goods or technical information. Licenses are required for those items for which the U.S. specifically controls exports for reasons of national security, foreign policy or short supply. Regulations and federal laws implementing U.S. sanction regimes (both unilateral and treaty-based) may also restrict transactions with, and provision of services to, certain countries, persons or entities.

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A wide array of license exceptions are available, however, for exports to many countries, persons and entities. An exporter should first obtain the proper classification of a commodity or technology

to be exported under U.S. regulations in order to determine which of the many exceptions may apply to the transaction.

If a license exception is not available for the export of a specific product or specific data to a specific destination, person or entity, it is necessary to apply for and obtain a license from the U.S.

Department of Commerce prior to the export. Certain commodities and technologies cannot be exported to any country without an individual license, while others may require a license for shipment only to specified countries. For purposes of U.S. export control regulations, export of technical information occurs when the information is disclosed to a foreign national even if such disclosure occurs in the U.S. Thus, if disclosure of information is subject to a license requirement, it may not be made to a foreign national without first obtaining the necessary license, whether or not the disclosure is to occur outside the U.S. This aspect of the export control regime often leads to unexpected restrictions on hiring and sharing of information. U.S. export control regulations have been revised to permit many commodities formerly requiring a license to be exported pursuant to license exceptions. Despite the revisions, however, licenses will continue to be required for many commodities, and the procedures for obtaining such licenses will continue to be time-consuming.

Foreign Trade Zones

Foreign trade zones are areas in or adjacent to ports of entry that are treated as outside the customs territory of the U.S. In order to expedite and encourage trade, goods admitted into a foreign trade zone are generally not subject to the customs laws of the U.S. until they are ready to be imported into the U.S. or exported. These

foreign trade zones are isolated, enclosed and policed areas that contain facilities for handling, storing, manufacturing, exhibiting and reshipping merchandise. Foreign trade zones are created pursuant to the Foreign Trade Zones Act (19 U.S.C. §§ 81a–u) and are operated as public utilities under the supervision of the Foreign Trade Zones Board. Under the Foreign Trade Zones Act, the board is authorized to grant to public or private corporations the privilege of establishing a zone. Regulations covering the establishment and operation of foreign trade zones are issued by the Foreign Trade Zones Board, while U.S. Customs Service regulations cover the customs requirements applicable to the entry of goods into and removal of goods from these zones.

Antidumping and Countervailing Duties

The U.S. antidumping law (19 U.S.C. §§1673–1677) provides that if a foreign manufacturer sells goods in the U.S. at less than fair value and such sales cause or threaten material injury to a U.S. industry or materially retard the establishment of a U.S. industry, an additional duty in an amount equal to the “dumping margin” is to be imposed upon the imports of that product from the foreign country where such goods originated. Under the statute, sales are deemed to be made at less than fair value if they are sold at a price that is less than their foreign market value (which is generally equivalent to the amount charged for the goods in the home market). The dumping margin is equal to the amount by which the foreign market value exceeds the U.S. price. The U.S. countervailing duty law (19 U.S.C. §§1671–1677) also imposes a duty on imported merchandise manufactured in or exported to the U.S. with subsidies provided by foreign governments. Such subsidies take various forms, such as direct cash payments, credit against taxes, or loans

with artificially low interest rates, or other terms more favorable than market conditions. By imposing countervailing duties, U.S. law protects domestic industries against unfair competitive advantage that foreign manufacturers and exporters receive from subsidized programs. Unlike antidumping duties, depending on the country from which the subsidy merchandise originates, countervailing duties may sometimes be imposed without application of a material injury test. The Secretary of Commerce is charged with determining whether merchandise is being sold at less than fair value in the U.S. or if its manufacture, production or export to the U.S. has been subsidized. The International Trade Commission makes the determination of whether such sales cause or threaten material injury to a U.S. industry.



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